No. 01-___

IN THE

Supreme Court of the United States

NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES,

Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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United States Court of Appeals,
Fifth Circuit.

TEXAS OFFICE OF PUBLIC UTILITY COUNSEL; National Association of State Utility Consumer Advocates, Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION; United States of America, Respondents.

No. 00-60434.

Sept. 10, 2001.

On Petition for Review of a Final Order of the Federal Communications Commission.

Before Emilio M. Garza and Parker, Circuit Judges, and ELLISON, District Judge.

EMILIO M. GARZA, Circuit Judge:

This petition for review of the CALLS Order [FN 1] represents the latest challenge to the Federal Communication Commission's implementation of the Telecommunications Act of 1996, Pub.L. No. 104-04, 110 Stat. 56 (codified as amended in scattered sections of title 47, United States Code) ("1996 Act"). The Texas Office of Public Utility Counsel ("TOPUC") and the National Association of State Utility Consumer Advocates ("NASUCA"), along with intervenor Consumer Federation of America ("CFA") (collectively, "Petitioners"), claim that the CALLS Order violates the procedural requirements of

the Administrative Procedure Act, 5 U.S.C. § 706(2)(A) as well as the substantive provisions of the 1996 Act. We affirm the CALLS Order in most respects, but we remand for further analysis the portions regarding the $650 million Universal Service Fund and the X-Factor.

FN1 The CALLS Order is officially named *In the Matter of Deployment of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Distance Users, and Federal-State Joint Board on Universal Service*, Sixth Report and Order in CC Docket No. 96-262 and 94-1, and Report and Order in CC Docket 99-249, and Eleventh Report and Order in CC Docket 96-56, 15 FCC Rcd. 12962 (released May 31, 2000). The order derives its appellation from the Coalition of Affordable Local and Long Distance Service ("CALLS"), a group of local and long- distance providers that helped draft the initial proposal.

I

We must briefly review the regulatory regime of the telephone industry to better understand the issues presented in this petition. The telephone industry is comprised of two sets of carriers. Local exchange carriers ("LECs") provide local basic telephone service, while interexchange carriers ("IXCs") offer long-distance service. Since the divestiture of AT&T in 1984, robust competition has existed in the long-distance market with IXCs trying to recruit new customers and lure subscribers from each other. On the other hand, LECs until recently had natural monopolies on local service in their respective regions, because they own the network infrastructure necessary to make telephone

calls. The prohibitive capital costs involved in laying out a separate infrastructure deterred potential competitors from entering the local service market. The 1996 Act made competition in the local basic service market one of its main goals. Congress prodded incumbent local exchange carriers ("ILECs")--that is, LECs like the Baby Bells which own the infra *318 structure--to provide cost-based use of their network to companies that wanted to enter the local service market. In return, Congress allowed ILECs, which had previously been barred from offering long-distance service in their home regions, to enter that market.

The 1996 Act's provision of allowing LECs to use ILECs' infrastructure resembled an arrangement already shared by IXCs and ILECs: IXCs rely on ILECs' network to originate and terminate long-distance calls. More technically, the IXCs use the "local loop," which refers to telephone wires running from a person's telephone to the local telephone switch. Whenever someone makes a long-distance phone call, he or she taps into the local network, where the call is then routed between a LEC local switch and an IXC switch. The costs incurred by the ILECs in providing the use of this infrastructure are called "loop costs."

Two sources of revenues allow the ILECs to recover the loop costs. First, all end-users of basic local service pay a flat Subscriber Line Charge ("SLC") that appears in their monthly telephone bills. Prior to the CALLS Order, the FCC capped the SLC at $3.50 per month: ILECs can charge less than $3.50 per month, but it cannot levy an access charge above that amount. The SLC alone is insufficient to defray the loop costs entirely. Thus, the FCC assesses an access charge against IXCs, which in turn usually pass down these costs to end-users. At first, the FCC levied a traffic-sensitive fee called the Common Carrier Line Charge

("CCL") against IXCs. The FCC later replaced the CCL with the flat-rate Presubscribed Interexchange Carrier Charge ("PICC"). *See Access Charge Reform Order, Price Cap Reform Performance Review for Local Exchange Carriers, Transport Structure and Pricing, End User Common Line Charges,* CC Docket Nos. 96-262, 94-1, 91-213 and 95-72, First Report and Order, FCC 97-158, 62 Fed. Reg. 31867 (released May 16, 1997) ("Access Charge Reform Order"). The FCC determined that high-volume long-distance callers did not financially burden the network more than low-volume callers, but were nevertheless being penalized by a traffic-sensitive CCL charge. The FCC believed that the flat-rate PICC more accurately represented the true costs incurred by long-distance callers.

In addition to fostering competition in the local telephone service market, the 1996 Act had another key goal of continuing the provision of affordable universal service to all Americans. Traditionally, the phone bills of poor and rural customers have been implicitly subsidized by rate manipulation. High- volume long-distance callers and urban residents pay artificially higher phone bills to subsidize and support universal service for others. Congress recognized that these implicit subsidies could not continue under the market- based regime ushered in by the 1996 Act. In a competitive market, a carrier that subsidizes rural or poor customers by charging below-cost rates while billing above-cost rates to urban customers will be undercut by a competitor offering at-cost rates to urban end-users. Congress wanted to continue subsidizing universal service, but in a way more consistent with the market- oriented reforms. The 1996 Act thus required that the implicit subsidy system of rate manipulation be replaced with explicit subsidies for universal service. To implement the goals of the 1996 Act, the FCC issued a series of orders.

The FCC first issued its Access Charge Reform Order. As noted before, the order abolished the traffic-sensitive CCL fees assessed against IXCs, and replaced them with the flat-rate PICC. By ensuring that *319 access charges more accurately reflected the actual costs incurred, the FCC hoped that it would facilitate the shift to a competitive market. The order also increased the SLC cap for multi-line business customers on the assumption that they could afford such a price increase. It, however, did not increase the SLC cap for primary residences and single-line businesses. Several IXCs petitioned for review of the Access Charge Reform Order, alleging, among other things, that the failure to increase the SLC cap on primary residential and single-line businesses amounted to new implicit subsidies. The Eighth Circuit upheld the Access Charge Reform Order in part on the ground that the 1996 Act's commitment to universal access constrained the FCC from raising the SLC price-cap on other lines. *See Southwestern Bell Tel. Co. v. FCC, 153 F.3d 523 (8th Cir. 1998)* (citing 47 U.S.C. § 254(b)'s statement of affordable universal access). Noting that the order was a transitional plan only, the court further upheld the FCC's decision to rely on market forces rather than on comprehensive cost analysis in changing its access charge policy.

The FCC also issued *In re Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Report and Order, 12 FCC Rcd. 8776 (1997) ("Universal Service Order"). This order emphasized that implicit subsidies for universal service should be gradually removed from interstate access charges, and replaced with an explicit universal service fund derived from percentage- based fees levied against telecommunications carriers. This Circuit remanded parts of the order, but we upheld the requirement that LECs must reduce access charges by an amount commensurate with the money received for the explicit universal service fund. *See*

Texas Office of Pub. Util. Counsel v. FCC, 183 F.3d 393 (5th Cir. 1999) ("*TOPUC I*").

Finally, the FCC addressed the issue of the "X-Factor" in its *In the Matter of Price Cap Performance Review for Local Exchange Carriers,* CC Docket 96-262, Fourth Report and Order, 12 FCC Rcd. 16,642 (1997) ("Price Cap Review"). FCC had annually reduced LECs' price-caps by imposing what it dubbed the X-Factor, a percentage number that represented the LECs' increase in productivity minus the rate of inflation. By lowering the price-caps (and hence the amount that LECs could charge consumers), the X-Factor pressured LECs to become more efficient and to lower their costs. In effect, the X-Factor passed down the savings from the LECs' increased productivity to the consumers. In its Price Cap Review, the FCC raised the X-Factor to 6.5 percent. On petition for review, the D.C. Circuit found the increase to be arbitrary and capricious because the FCC did not provide sufficient evidence of increased productivity by the LECs to warrant the 6.5 percent figure. *See United States Tel. Ass'n v. FCC,* 188 F.3d 521 (D.C. Cir. 1999) ("*USTA*"). It remanded this issue back to the FCC.

While revisiting the two remanded orders from *USTA* and *TOPUC I,* the FCC considered and adopted the CALLS Order, a five-year transitional plan intended to help resolve the thorny issues of access charges. This order originates from the work of the Coalition for Affordable Local and Long Distance Service ("CALLS"), a group of major IXCs and ILECs. Although ILECs and IXCs traditionally have held opposing views on telecommunications reform, they worked together in jointly presenting the CALLS proposal. The FCC conducted a notice-and-comment proceeding pursuant to the Administrative Procedure Act ("APA") by soliciting public comments on the proposal and receiving

dozens of comments. After making some changes, the FCC submitted a modified *320 CALLS proposal, and again solicited comments but on an abbreviated schedule. Several weeks later, the FCC issued the final CALLS Order.

The CALLS Order promulgates four key changes, all of which are challenged in this petition for review. First, the FCC abolishes the PICC fees assessed against IXCs. Second, to compensate for the loss of revenues from the elimination of the PICC, the order raises the SLC price cap for primary residential lines. It will increase from $3.50 to $6.50 over a period of several years. The FCC changed the fee structure, believing that it would encourage more competition and lead to lower rates overall for consumers. Third, the FCC reintroduces a 6.5 percent X-Factor, but switches it from a productivity proxy to a non-productivity-based mechanism for rate reduction. Fourth, it establishes a transitional $650 million Universal Service Fund to provide explicit subsidies for poor and rural customers.

The parties challenging the CALLS Order include the Texas Office of Public Utility Counsel, as well as the National Association of State Utility Consumer Advocates and the intervenor Consumer Federation of America, both of which are consumer advocacy groups. [FN 2] In their petition, they make two broad challenges against the order. The Petitioners first contend that the CALLS Order did not comport with the APA requirements. They characterize the CALLS Order as the product of asurreptitious political deal between the respondent FCC and the respondent-intervenor CALLS Coalition. The Petitioners also challenge the order on substantive grounds, claiming that it betrays, among other things, the 1996 Act's requirement of affordable universal access. We first address the substantive statutory challenge, and then the procedural objections to the CALLS Order.

FN2. The Petitioners have filed two opening briefs: TOPUC and CFA jointly filed a brief, while NASUCA filed separately. For the purpose of brevity, this opinion will not attempt to identify the specific arguments made by each brief, and will instead refer to them collectively as the Petitioners' argument or brief. Similarly, the respondents in the case, the FCC and the CALLS Coalition have filed separate briefs, but we will not individually identify the arguments made by each respondent.

II

In reviewing the Petitioners' substantive claims, we apply the two-step analysis set forth in Chevron U.S.A. Inc. v. Natural Res. Def. Council, 467 U.S. 837, 842-43, 104 S. Ct. 2778, 2781-2783, 81 L.Ed.2d 694 (1984). In step one, we look to see whether Congress has spoken directly on the precise question at issue. *See id.* at 843, 104 S. Ct. at 2781. If Congress has done so, we must "give effect to [Congress'] unambiguously expressed intent." *Id.* at 843, 104 S.Ct. at 2781. If the statute is ambiguous as to the question at issue, we move to the second step of the *Chevron* analysis to determine "whether the agency's answer is based upon a permissible construction." *Id.* at 843, 104 S.Ct. at 2782. Under this second step, we can reverse the agency's decision only if it was arbitrary, capricious or manifestly contrary to the statute. *See id.* at 844, 104 S.Ct. at 2782. The question is not whether we might have preferred another way to interpret the statute, but whether the agency's decision was a reasonable one. *See MCI Telecomm. Corp. v. FCC*, 675 F.2d 408, 413 (D.C. Cir. 1982).

We address in order the Petitioners' three main objections to the CALLS Order: whether the SLC price cap increase violates § 254(b)(1) and § 254(i)'s purported affordability mandate; whether it contravenes § 254(k)'s prohibition against unreasonable ***321** allocation of joint and common costs; and whether the 1996 Act requires the FCC to conduct a comprehensive, forward- looking study.

A

The Petitioners object to the increase in the SLC caps for residential and single-line business customers, alleging that it violates the affordability mandate of 47 U.S.C. § 254 and arbitrarily reverses the long- settled agency policy of ensuring affordable universal service. We hold that the increase in the SLC price cap does neither: the FCC has reasonably interpreted § 254 under step-two of the *Chevron* analysis, and has provided sufficient justification for its change in price cap policy.

The Petitioners point to two statutory provisions that allegedly preclude the FCC from increasing the SLC cap. Section 254(b)(1) states that "[q]uality services should be available at just, reasonable, and affordable rates," and § 254(i) declares that "[t]he Commission and the States should ensure that universal service is available at rates that are just, reasonable and affordable." 47 U.S.C. § 254(I), 254(b)(1). The FCC acknowledges the importance of affordability under the 1996 Act, but states that it is only an aspirational guideline that must be carefully balanced with other statutory objectives. In response, the Petitioners imply that the FCC must make affordability paramount in formulating access charge policy, even if it comes at the expense of other statutory goals.

We hold that the FCC's interpretation § 254(b)(1) and

254(i) as merely aspirational is permissible under step-two of the *Chevron* analysis. Accordingly, the two provisions cannot serve as a basis to invalidate the SLC price cap increase (assuming that the increase endangers affordability, which the FCC denies).

We first discuss § 254(b)(1). Under the heading of "[u]niversal service principles," § 254(b) lists seven factors that the FCC should follow in implementing the 1996 Act. [FN 3]One of the principles is that "[q]uality service should be at ... affordable rates." 47 U.S.C. § 254(b)(1). We have previously analyzed § 254(b) under *Chevron* step-two because the listed principles use "vague, general language," rendering the section ambiguous. TOPUC I, 183 F.3d at 421 (analyzing § 254(b)(3)). Under this deferential review, we have approved the FCC's interpretation of the statutory principles as aspirational only. *See id.*, 181 F.3d at 421 (refusing to "rely[ ] on the aspirational language in § 254(b) to bind the FCC to adopt certain cost methodologies for calculating universal service support"); *see also Chevron* at 843, 104 S.Ct. at 2778 (holding that courts must defer to an agency's reasonable reading of an ambiguous provision). Indeed, the lofty and expansive language of § 254(b) "hardly constitute[ ] a series of specific statutory commands." TOPUC I, 183 F.3d at 421. Rather, they "reflect congressional intent to delegate difficult policy choices to the Commission's discretion." *See Alenco*, 201 F.3d 608, 615 (5th Cir. 2000); *cf. Nat'l Ass'n of Regulatory Util. Commr's v. FCC*, 737 F.2d 1095, 1134 (D.C. Cir. 1984) (noting the "breadth of the Commission's statutory discretion to balance the multiple goals embodied in the Communications Act.").

FN3. The headings of the seven principles are: "Quality and rates"; "Access to advanced services";

> "Access in rural and high cost areas"; "Equitable and nondiscriminatory contributions"; "Specific and predictable support mechanisms"; "Access to advanced telecommunications services for schools, health care, and libraries"; and a catch-call "Additional principles." 47 U.S.C. § 254(b)(1)-(7).

***322** Similarly, we hold that the FCC's reading of § 254(i) as aspirational is a "permissible construction of the statute." Chevron at 843, 104 S.Ct. at 2778. Section 254(i) states that the FCC "*should* ensure that universal service is ... affordable." Generally, courts have "read 'shall' as a more direct statutory command than words such as 'should' or 'may.' " TOPUC I, 183 F.3d at 418. The Petitioners counter that courts nevertheless sometimes read "should" as a direct statutory command. *See, e.g., Alenco*, 201 F.3d at 614-615. While that may be true, the Petitioners do not provide any convincing reasons why the word "should" in this context must be read to rebut the general presumption. The Petitioners' argument shows only that, at best, the meaning of § 254(i) is unclear. If a statutory provision is ambiguous, we must uphold the FCC's interpretation as long as it is a reasonable reading. *See Chevron* at 843, 104 S.Ct. at 2778.

Thus, while the FCC cannot flatly ignore or contravene the goal of affordability, Congress gave it the latitude to formulate a policy that considers affordability, along with other policy goals of the 1996 Act. We cannot arrogate to ourselves this policy-making function, merely because we (or the Petitioners) believe that the FCC is not maximizing the affordability goal at the expense of other objectives. As we explain later, the increase in the SLC cap represents FCC's reasoned attempt to maintain the difficult balance between the principles of ensuring affordability and encouraging competition.

Notwithstanding the statutory provisions, we cannot uphold FCC's decision to increase the SLC caps if it represents an unexplained reversal of past FCC policy. "While the agency is entitled to change its views on the acceptability of [a prior policy], it is obligated to explain its reasons for doing so." *Motor Vehicle Mfrs. Ass'n v. State Farm. Mut. Auto Ins. Co.*, 463 U.S. 29, 56, 103 S.Ct. 2856, 2873, 77 L.ed.2d 443 (1983). The Petitioners allege that FCC has reversed itself from its earlier decisions not to raise the SLC cap on residences and single-line businesses due to affordability concerns. *See, e.g.*, Access Charge Reform Order, § 73 (increasing the SLC cap only on multi-line businesses).

The FCC has articulated rational reasons to the degree that it has changed prior policies. [FN 4] Simply put, the telecommunications market has undergone dramatic changes in the past few years, and it continues to do so. In light of this dynamic market, the FCC has walked a delicate tightrope between the 1996 Act's twin goals of ensuring affordability and promoting local service competition. We have implicitly recognized that an uneasy tension exists between these two goals: although increased competition will ultimately make phone service more affordable, the transition from a highly-regulated industry to a market-oriented regime can bring ***323** some growing pains. *See Alenco*, 201 F.3d at 615. As a consequence, while the "FCC must see to it that *both* universal service and local competition are realized," we have also recognized that "Congress has conferred broad discretion on the agency to negotiate these dual mandates [and that] courts ought not [to] lightly interfere with its reasoned attempt to achieve both objectives." Id. at 615 (emphasis in original).

FN4. As an initial point, the Petitioners err in intimating that the FCC refused to increase the SLC cap on residential and single-line business customers solely because of affordability. The FCC did not increase the SLC cap for several reasons, including the prudential rationale of not altering the rate structure at a time of rapid reform. For example, in the Access Charge Reform Order, the FCC explained: "Because of concerns about affordability, *and* in light of the significant changes that are still underway in this proceeding, in the federal universal service support proceeding, *and* possible future changes to the separations process, we conclude that the SLC for [residential and single-line business] lines should not be raised." *Id.* (emphasis added). Likewise, the FCC explained in its Universal Service Order that it would not raise "at this time" the SLC caps "in light of significant changes that are still underway." Universal Service Report, § 763.

Citing several factors and changes in the market, the FCC believed that its prior concerns about affordability were "sufficiently mitigated to allow an increase in the SLC" from $3.50 to $6.50 over the course of several years. CALLS Order, § 86. First, the FCC noted that the prior SLC limit of $3.50 was established in 1984; if adjusted for inflation, it would stand at $4.94. *See id.* at § 85. In light of this, the FCC did not find that an increase in the SLC cap would raise affordability concerns. Second, it cited empirical evidence suggesting that telephone subscribership would not be "negatively impacted" by such an increase. *See id.* at § 86. The FCC also noted that increased funding for the Lifeline support program allayed prior fears of unaffordability. Finally, the FCC promised to conduct a cost-study before the SLC is scheduled to rise above $5.00.

In addition, the FCC believed that pro-competitive benefits from the abolition of the PICC would offset any increase in the SLC. Although the PICC is technically assessed against the IXCs, they usually pass it down, with added costs, to the end-users. *See id.* Eliminating the PICC would remove such unnecessary transaction costs. The FCC further reasoned that consumers would benefit because the PICC, as an external cost imposed on all IXCs, is relatively resistant to competitive pressures. *See* CALLS Order, § 89. Consequently, the FCC believed that it would be difficult for the IXCs to reduce and compete away this fee. *See id.* On the other hand, only the ILECs assess the SLC, which is imposed directly against the consumers. The newly entering LECs are not required to charge the SLC. Thus, the FCC held that competitive pressure could force ILECs to reduce the SLC through efficiency gains. *See id.*

The Petitioners strongly dispute the FCC's reasoning. For example, they reply that the FCC's logic about the PICC is counterintuitive because the long- distance market is currently more competitive than the local service market. Under our standard of review, we are not required to concur wholeheartedly with the policy analysis of the FCC. Rather, we only examine whether "prior policies and standards are being deliberately changed" and "not casually ignored." *Bush-Quayle '92 Primary Comm., Inc. v. FEC*, 104 F.3d 448, 453 (D.C. Cir. 1997). After reviewing the record, we are satisfied that the FCC has sufficiently explained its reasons for increasing the SLC for residential and single-line business customers. The Petitioners may not agree with the FCC's reasoning, but we cannot usurp the FCC's role in making the difficult policy decisions regarding affordability and competition. *See Alenco*, 201 F.3d at 615.

B

The Petitioners also challenge the CALLS Order on the ground that it recovers an unreasonably disproportionate amount of joint and common costs of universal service from end-users. At dispute is the meaning of § 254(k), which states that the FCC "shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of ***324** facilities used to provide these services." 47 U.S.C. § 254(k). By abolishing the PICC fee assessed against IXCs and increasing the SLC cap on end-users, the FCC unreasonably recovers 100 percent of joint and common costs of universal service from end-users, according to the Petitioners.

One of the Petitioners, TOPUC, had presented this very same argument in challenging the Access Charge Reform Order, which had increased the SLC price cap on multi-line businesses. The Eighth Circuit wholly rejected that argument in Southwestern Bell. It noted that "[b]ecause the SLC is a method of recovering loop costs, not an allocation of those costs between supported and unsupported services, § 254(k) is not implicated." Southwestern Bell, 153 F.3d at 559. We agree with the Eighth Circuit. Section 254(k) concerns cost allocation of joint and common costs, while the SLC and the PICC involve the recovery of such costs. Thus, § 254(k) does not implicate the SLC or the PICC: cost recovery involves how and from whom the funds are collected, while cost allocation refers to how the costs are disbursed. [FN5]

FN5. In any case, as a practical matter, the Petitioners' fears of anti-consumer effects are exaggerated. Both sides apparently agree that most

customers have a presubscribed long-distance carrier, and that IXCs pass down the PICC charge, along with transaction costs, to their customers. Moreover, even "[i]f an end-user customer does not have a presubscribed interexchange carrier," he may not be able to avoid the PICC because "the local exchange carrier may collect the PICC directly from the end user." 47 C.F.R. § 69. 153 (2000). Hence, from a policy perspective, end-users will be assessed access charges, whether directly through the SLC or indirectly through the PICC or through a combination of both; thus, a more appropriate question, at least in terms of impact on consumers, is whether the net burden on consumers will be lower or higher.

C

In enacting the 1996 Act, Congress established the goal that network access charges should eventually reflect the actual costs of providing and administering the particular network service. To meet this objective, the FCC has primarily relied on market forces to restructure the access charges. The Petitioners maintain that the FCC has failed to conduct a comprehensive, forward-looking cost-study in violation of the 1996 Act. We reject this argument.

The 1996 Act does not compel the FCC to conduct forward-looking cost-studies because the cost-study requirements of § 251(c)(1) and 252(d)(1) do not apply to the interstate access services at issue in this petition. *See Competitive Telecomm. Ass'n v. FCC, 117 F.3d 1068, 1072 (8th Cir. 1997).* ("[I]t is clear from the Act that Congress did not intend all access charges to move to cost-based pricing, at least not immediately. The Act plainly preserves certain

rate regimes already in place."). Instead, § 201(b) and 202(a)'s broader standard that interstate service rates be "just and reasonable" without "unreasonable discrimination" applies here. *See* 47 U.S.C. §§ 201(b), 202(a). This "just and reasonable" standard gives the FCC discretion in structuring the access charges. The FCC accordingly has delayed conducting a forward-looking cost-study because of time constraints and the technical uncertainty involved in carrying out a reliable cost study. In lieu of cost-studies, the FCC has primarily relied on competitive pressures to lower costs.

The Eighth Circuit earlier upheld the FCC's reliance on the market to restructure rates. *See Southwestern Bell*, 153 F.3d at 547 (noting that "[d]ue to the difficulty in creating a reliable forward-***325** looking cost model for interstate access services, a prescriptive plan would not be feasible at the present time"). The Petitioners remind the court that nearly three years have passed since the Eighth Circuit's decision. Although we recognize that the FCC has not acted as quickly as the Petitioners would want, we cannot say that the FCC has acted arbitrarily or capriciously, given the transitional nature of the CALLS Order. *See Alenco*, 201 F.3d at 616 (giving special deference to transitional rules). We are further assured by the FCC's promise to conduct a cost-study before the SLC cap is set to rise over five dollars. In sum, we believe that the Eighth Circuit's analysis in *Southwestern Bell* is apropos here:

> The FCC has reasonably exercised its predictive judgment in concluding that competition in the local telephone services market will effectively drive interstate access charges to economic costs. If, in light of the actual market developments, the Commission determines that competition is not having the anticipated effect on access charges, the agency presumably will revisit the issue. We

> cannot conclude at this time that the FCC's decision to adopt a market-based approach was arbitrary ... in light of the broad discretion Congress has given the Commission in setting interstate rates.

Southwestern Bell, 153 F.3d at 547.

III

The Petitioners allege that the FCC's procedures in formulating the CALLS Order were fatally defective and in violation of the APA. *See* 5 U.S.C. § 706(2)(A). They claim that the FCC failed to follow appropriate notice-and-comment procedures; that it acted arbitrarily and capriciously in establishing the $650 million figure for the Universal Service Fund, and that it provided no rational basis to support a 6.5 percent X-Factor.

In reviewing an agency's procedures under the APA, we apply the arbitrary and capricious standard, recognizing that particular deference is accorded to transitional rules. *See Alenco*, 201 F.3d at 616. We cannot "substitute [our] judgment for that of the agency." *State Farm* at 43, 103 S.Ct. at 2866. Our role is "to review the agency action to determine whether the decision 'was based on a consideration of the relevant factors and whether there was a clear error of judgment.' " *State of Louisiana v. Verity*, 853 F.2d 322, 327 (5th Cir. 1988) (quoting *State Farm*).

A

The Petitioners characterize the CALLS Order as a tainted political compromise between the FCC and the CALLS Coalition. Specifically, the abbreviated second round of notice-and-comment and the *ex parte* contact between the FCC and the CALLS Coalition suggest that the

FCC had given approval to the proposed order before considering public comment, according to the Petitioners. We hold that the CALLS Order is the product of a valid, if not perfect, informal notice-and-comment rulemaking proceeding. The APA requires federal agencies that conduct informal rulemaking to give notice of a proposed rule and consider public comment on it. *See* 5 U.S.C. § 553. This process allows "interested persons an opportunity to participate" in the rulemaking process through the submission of written comments. *See* 5 U.S.C. § 553(c). An agency's failure to comply with the APA requirements "leads in the direction of arbitrary decision-making." *United States v Nova Scotia Food Prod. Corp.*, 568 F.2d 240, 250 (2d Cir. 1976).

***326** Before it promulgated the final CALLS Order, the FCC held a round of notice-and-comment proceedings for each of its two drafts of the proposed order. The FCC released the original CALLS proposal for public comment on September 15, 1999. Over the course of the next few months, the FCC solicited and received written submissions from dozens of interested parties. In all, the FCC received comments from 36 parties, and reply comments from 29 parties. The Petitioners apparently do not dispute that this first round of notice-and- comment met the APA requirements.

After receiving and considering these comments, the FCC revised the proposed order and released a modified CALLS proposal which took into account concerns about the affordability of the increase in the SLC price cap. The FCC held an abbreviated notice-and-comment period for the revised draft of the proposed order, and issued the final CALLS Order about two months later. The Petitioners complain that this shortened second round of notice-and-comment violated the APA. Furthermore, they point to

several *ex parte* contacts between the FCC and the CALLS Coalition. According to the Petitioners, the abbreviated schedule for the revised draft of the proposed order, along with the *ex parte* communication, suggests that the FCC gave "at least tacit approval [of the revised proposed order] ... long before initiation of the second comment period." In short, they accuse the FCC of flouting the procedural safeguards that ensure meaningful participation by the public in the rulemaking process.

We find the Petitioners' objections without merit. Even if we assume that the abbreviated second round of notice-and-comment did not fully meet the APA requirements, it would not undermine the validity of the CALLS Order because the FCC was not legally required to offer an additional period of notice-and-comment. We have held that "[i]f, after notice and comment, the agency alters the proposed rule, a new comment period will not be required so long as the modified rule is a 'logical outgrowth of the published proceedings.' " *United Steelworkers of Amer., AFL-CIO-CLC v. Schuylkill Metals Corp.*, 828 F.2d 314, 317-18 (5th Cir. 1987).

The revised version of the proposed order was a "logical outgrowth" of the original proposal, which the Petitioners concede met the APA requirements. The modified proposal retained the essential framework of the original proposal, but it added a few provisions to allay affordability concerns (e.g., requiring a cost-study before increasing the SLC cap over five dollars). In other words, had the FCC not even held a second notice-and-comment period, the Petitioners would have no grounds for complaint. We believe that the FCC's second notice- and-comment period, even if it was abbreviated, went above and beyond what the APA legally requires.

Moreover, while interested parties should be able to participate meaningfully in the rulemaking process, the public "need not have an opportunity to comment on every bit of information influencing an agency's decision." *See State of Tex. v. Lyng, 868 F.2d 795, 800 (5th Cir. 1989).* (allowing an agency to withdraw regulations and announce modified ones without taking additional comments). Accordingly, the petitioners must show how they were prejudiced by the FCC's failure to solicit additional comments, and how they would have responded had they been given the opportunity to submit additional responses.***327** [FN 6] *See id.* at 799. The Petitioners fail to meet this burden.

> FN6. Similarly, the Petitioners' complaint that they did not have an opportunity to comment on the late-filed Industry Analysis Division study lacks merit. They do not explain how they would have responded to the IAD study, and how the lack of opportunity to comment prejudiced them. *See Lyng*, 868 F.2d at 799. They also do not respond to the FCC's assertion that the study relied on publicly available data.

We also reject the Petitioners' speculative and perhaps sinister scenario imputed to the *ex parte* communication between the FCC and the interested parties. The APA permits *ex parte* contact between an agency and private parties as long as the agency adequately gives notice of such contact. *See* 47 C.F.R. § 1,1206(a) (stating that "*ex parte* presentations ... to or from Commission decision-making personnel are permissible ... provided that [they] ... are disclosed"). The Petitioners initially charged the FCC of failing to file such notices, but later retracted that

accusation. The record reflects that the FCC properly disclosed the *ex parte* contacts.

Generally, *ex parte* contact is not shunned in the administrative agency arena as it is in the judicial context. In fact, agency action often demands it. As the D.C. Circuit explained, "Under our system of government, the very legitimacy of general policymaking performed by unelected administrators depends in no small part upon the openness, accessibility and amenability of these officials to the needs and ideas of the public from whom their ultimate authority derives, and upon whom their commands must fall." *Sierra Club v. Costle*, 657 F.2d 298, 400-401 (D.C. Cir. 1981).

Finally, we do not agree with the Petitioners that the FCC's private contact with interested parties triggered the procedural mandates of the Negotiated Rulemaking Act of 1990 ("NRA"). *See* 5 U.S.C. § 561. The plain language of the statute undermines the notion that the NRA's procedures are mandatory. The preface of the statute states that, "Nothing in this subchapter should be construed as an attempt to limit innovation and experimentation with the negotiated rulemaking process or with other innovative rulemaking procedures otherwise authorized by law." 5 U.S.C. § 561. The substantive provisions of the statute further reinforce the permissive nature of the NRA. *See, e.g.*, 5 U.S.C. § 563(a) ("An agency *may* establish a negotiated rulemaking committee ...") (emphasis added); 5 U.S.C. § 563(b) ("An agency *may* use the services of a convener ...") (emphasis added). The Petitioners fail to cite (and we do not find) any cases contravening the plain language interpretation of the statute.

B

We hold that the FCC acted arbitrarily and capriciously

in establishing the $650 million amount for the Universal Service Fund. As a part of its goal to replace the implicit subsidy system of rate-manipulation, the FCC promulgated the Universal Service Fund, a five-year transitional plan designed to provide explicit subsidies to poor and rural end-users. In trying to determine the appropriate amount for the Universal Service Fund, the FCC considered six studies, whose estimates ranged from $250 million to $3.9 billion. The Petitioners accuse the FCC of arbitrarily averaging the estimates of the six cost-studies without exercising any independent judgment of its own. *See Laclede Gas Co. v. FERC*, 997 F.2d 936, 947 (D.C. Cir. 1993) (holding that FERC failed to exercise independent judgment in approving a settlement amount merely because it fell within the range of amounts in the record).

***328** Although we do not agree with the Petitioners' contention that the FCC merely averaged the estimates, we find that the FCC failed to exercise sufficiently independent judgment in establishing the $650 million amount. *See id.* The FCC does not explain how it actually derived that figure, and instead seems to invoke the Goldilocks approach to rulemaking: noting that "[s]ome commentators argue that the size of the interstate access universal service mechanism is too large [while] [o]ther commentators argue that the size ... is too small," the FCC apparently believes that its approach is just right because it falls reasonably within the range of estimates. CALLS Order, § 204. The FCC also relies heavily on the fact that both the IXCs and LECs, which traditionally have had opposing interests, agree on the amount. *See id.* at § 202 ("Because of the divergent interests of these parties, we believe that the $650 million represents a sufficient amount ..."). An agency abdicates its role as a rational decision-maker if it does not exercise its own judgment, and instead cedes near-total deference to private parties' estimates--even if the parties agree

unanimously as to the estimated amount. *Cf. Laclede*, 997 F.2d at 946 ("Even when the customer support is unanimous, however, FERC retains the responsibility of making an 'independent judgment' as to whether the settlement amount constitutes a reasonable remedy.").

We recognize that identifying a specific amount is an "imprecise exercise," and that our review of the Universal Service Fund is especially deferential due to its transitional nature. *See id.* at § 201. However, the FCC must provide some explanation as to why it found one study more persuasive than the other, even if it does not determine a precise amount as the only "correct" figure. The CALLS Order hints at some reasoned analysis, suggesting that the AT&T study applied the FCC's synthesis model, while the ALTS and Time Warner studies made unwarranted assumptions. *See* CALLS Order at § § 202, 204. But the CALLS Order fails to address other studies. *See Natural Res. Def. Council v. EPA*, 859 F.2d 156, 194 (D.C. Cir. 1988) (requiring some independent analysis by the agency prior to adoption of a rule).

We remand to the FCC for further analysis and explanation in regards to the $650 million Universal Service Fund. [FN7]

> FN7. We find little merit as to the Petitioners' two other arguments regarding the Universal Service Fund. First, the FCC's failure to consider the TOPUC's cost-study is not a ground for remand. An agency need not respond to every study, and only has to address "significant comments." *See United States Satellite Broad. Co., Inc. v. FCC*, 740 F.2d 1177, 1188 (D.C. Cir. 1984). Second, we reject the Petitioners' argument that the FCC improperly failed

to consult with and receive certification from the Federal-State Joint Board. The statute requires consultation with the Joint Board for only the initial implementation of § 254's universal service requirement. *See* 47 U.S.C. § 254(a)(1). Any consultation afterwards is permissive. *See* 47 U.S.C. § 254(c)(2) ("The Joint Board *may,* from time to time, recommend to the Commission modifications ...") (emphasis added).

C

We also remand the X-Factor issue, finding that the FCC lacked a rational basis in the record to support the 6.5 percent figure. Prior to the CALLS Order, the FCC had designated the X-Factor as a proxy for the increase in the LECs' productivity minus the rate of inflation. The price caps for local services were reduced each year by the percentage represented by the X-Factor. The X-Factor thus had the effect of passing down to consumers the savings from increased productivity. ***329** In 1997, the FCC set the X-Factor at 6.5 percent. On a petition for review, the D.C. Circuit reversed and remanded the X-Factor issue, holding that there was no rational relationship between the 6.5 percent figure and the alleged increase in productivity. *See USTA*, 188 F.3d at 525.

In its CALLS Order, the FCC reintroduced the same 6.5 percent X-Factor, but stated that the revamped X-Factor serves a different function as a "transitional mechanism that operates to reduce rates at a certain pace, and [is no longer] ... linked to a specific measure of productivity." CALLS Order, § 140. Therefore, the FCC argues that the CALLS Order does not conflict with the D.C. Circuit's remand order in USTA, because the court had only required further justification of the 6.5% figure in light of its role as a

productivity proxy. Now that the X-Factor no longer is tied to productivity, the FCC claims that the 6.5 percent figure is acceptable. We disagree.

The new X-Factor suffers from the same infirmity as the prior one: the FCC has failed to show a rational basis as to how it derived the 6.5 percent figure. [FN8] *See State Farm* at 56, 103 S.Ct. at 2873. Even if the X-Factor is no longer tethered to any productivity measure, the FCC still needs to provide a rational explanation of how it derived the precise percentage. Otherwise, the FCC would have free reign to set the X-Factor arbitrarily and capriciously. It must justify why a 6.5 percent X-Factor is a more appropriate rate reduction measure, than, say, a .065 percent or 65 percent X-factor.

> FN8. We reject the FCC's claim that the Petitioners lack standing to raise the X-Factor issue. An organization has standing to bring a suit if its members suffer an actual or threatened injury. *See Texans United for a Safe Econ. Educ. Fund v. Crown Cent. Petroleum Corp.*, 207 F.3d 789 (5th Cir. 2000). As groups representing consumers, the Petitioners allege, among other things, that a non-productivity-based X-Factor will harm consumers because it will no longer pass down the efficiency savings to consumers, and indeed will eventually only offset inflation. The FCC counters that there is no nexus between the new X-Factor and the supposed harm to consumers caused by the 6.5% figure, because the D.C. Circuit had earlier rejected the consumer organizations' argument that the 6.5% figure was too high. The alleged harm here is not the 6.5% figure *per se,* but rather the revamped X-Factor's failure to pass down efficiency savings to

consumers.

IV

We uphold most parts of the CALLS Order, but remand to the FCC for further analysis and explanation of two portions of the CALLS Order: the $650 million Universal Service Fund and the 6.5% X-Factor.

The petition for review is DENIED IN PART and GRANTED IN PART. The CALLS Order is AFFIRMED IN PART, REVERSED IN PART, and REMANDED IN PART, in accordance with this opinion.

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)
Access Charge Reform	)
	)
Price Cap Performance Review for Local	)
Exchange Carriers	)
	)
Low-Volume Long-Distance Users	)
	)
Federal-State Joint Board on Universal	)
Service	)

CC Docket Nos. 96-262, 94-1, 99-249, 96-45

SIXTH REPORT AND ORDER IN CC DOCKET NOS. 96-262 AND 94-1
REPORT AND ORDER IN CC DOCKET NO. 99-249
ELEVENTH REPORT AND ORDER IN CC DOCKET NO. 96-45

Adopted: May 31, 2000
Released: May 31, 2000

By the Commission: Commissioner Furchtgott-Roth concurring in part, dissenting in part, and issuing a statement.

* * * * * *

INTRODUCTION

1. In this Order, we adopt an integrated interstate access reform and universal service proposal put forth by the members of the Coalition for Affordable Local and Long Distance Service (CALLS).[1] This action provides many benefits. It will bring lower rates and less confusion to consumers; and create a more rational interstate rate structure. This, in turn, will support more efficient

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[1] CALLS consists of the following members: AT&T, Bell Atlantic, BellSouth, GTE, SBC, and Sprint. They represent four of the five largest local exchange companies and two of the three largest long-distance companies in the nation. These local and long-distance companies have historically been adversaries in our access reform and universal service proceedings. CALLS first submitted its proposal on July 29, 1999 (Letter from John T. Nakahata, Counsel to CALLS, to Magalie Roman Salas, Secretary, FCC, July 29, 1999; resubmitted with edits on August 20, 1999 (Original Proposal)). CALLS submitted a modified proposal on March 8, 2000 (Letter from John T. Nakahata, Counsel to CALLS, to Magalie Roman Salas, Secretary, FCC, March 8, 2000 (Modified Proposal)). CALLS has made some refinements to its proposal since that date. *See* Appendix E. Unless otherwise indicated, the terms "CALLS Proposal" and "proposal" refer to the Modified Proposal, as revised by CALLS in its subsequent filings.

In reviewing the CALLS Proposal, the Commission has twice requested and received comment. Access Charge Reform, CC Docket 96-262, Notice of Proposed Rulemaking, 14 FCC Rcd 16872 (1999) (*CALLS NPRM*); Coalition for Affordable Local and Long Distance Services (CALLS) Modified Proposal, CC Docket No. 96-262, Public Notice, DA-00-533 (Comm. Carr. Bur., rel. Mar. 8, 2000). A comment or reply comment to the *CALLS NPRM* is identified as Comment or Reply, respectively. A comment or reply comment to the supplemental request for comment in the Public Notice is identified as Supp. Comment or Supp. Reply, respectively. Appendix A includes a list of parties filing comments on the CALLS Proposal and Low-Volume Long-Distance Users, CC Docket No. 99-249, Notice of Inquiry, 15 FCC Rcd 6298 (1999) (*Low-Volume Long-Distance Users NOI*).

competition, more certainty for the industry, and permit more rational investment decisions.

2. This Order resolves historically vexing issues, some going back nearly two decades, in a manner that benefits consumers. Consumers that make no or few long-distance calls and consumers that make many long-distance calls will both enjoy meaningful savings. The savings from the elimination of the Presubscribed Interexchange Carrier Charge (PICC) and the long-distance companies' pass-through of that charge exceed the modest increases to the Subscriber Line Charge (SLC) that this plan allows. In addition, the commitments by AT&T and Sprint to offer reasonably priced long-distance plans without any Minimum Usage Charge (MUC) ensures that low-volume users will enjoy substantially lower overall rates. At the same time, significant and immediate reductions to per-minute carrier access charges will bring those rates closer to cost and translate into lower per-minute long-distance rates, benefiting high-volume consumers.

3. By simultaneously removing implicit subsidies from the interstate access charge system and replacing them with a new interstate access universal service support mechanism that supplies portable support to competitors, this Order allows us to provide more equal footing for competitors in both the local and long-distance markets, while still keeping rates in higher cost areas affordable and reasonably comparable with those in lower cost areas.

II. BACKGROUND

4. In passing the Telecommunications Act of 1996 (1996 Act),[2] Congress sought to establish "a pro-competitive, deregulatory national policy framework" for the United States telecommunications industry. In the 1996 Act, Congress also directed that universal service support "should be explicit and sufficient to achieve the purposes" of section 254,[3] which include the purpose that all Americans should have access to telecommunications services at affordable and reasonably comparable rates. Therefore, with this Order, we take action designed to further accelerate the development of competition in the local and long-distance telecommunications markets, and to establish an explicit interstate access universal service support mechanism that will be sustainable in an increasingly competitive marketplace.

A. Access Charges

5. For much of this century, most telephone subscribers obtained both local and long-distance services from the same company, the pre-divestiture Bell System, owned and operated by AT&T. Its provision of local and intrastate long-distance services through its wholly-owned operating companies, the Bell Operating Companies (BOCs), was regulated by state commissions. The Commission regulated AT&T's provision of interstate long-distance service. Much of the telephone plant that is used to provide local telephone service, such as the local loop,[4] is also needed to originate and terminate interstate long-distance calls. Consequently, a

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2 Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act). The 1996 Act amended the Communications Act of 1934. 47 U.S.C. §§ 151 *et seq*.

3 47 U.S.C. § 254(e).

4 A local loop is the connection between the telephone company's central office building and the customer's premises.

portion of the costs of this common plant historically was assigned to the interstate jurisdiction and recovered through the rates that AT&T charged for interstate long-distance calls. The balance of the costs of the common plant was assigned to the intrastate jurisdiction and recovered through the charges for intrastate services regulated by the state commissions. The system of allocating costs between the interstate and intrastate jurisdictions is known as the separations process. The difficulties inherent in allocating the costs of facilities that are used for multiple services between the two jurisdictions are discussed below.

6. At first, there was no formal system of tariffed charges to determine how the BOCs and the hundreds of unaffiliated, independent local exchange carriers (LECs) would recover the costs allocated to the interstate jurisdiction by the separations rules. Instead, AT&T remitted to these companies the amounts necessary to recover their allocated interstate costs, including a return on allocated capital investment.

7. In the 1970s, MCI and other interexchange carriers (IXCs) began to provide switched long-distance service in competition with AT&T. AT&T, however, still maintained monopolies in the local markets served by its local subsidiaries, the BOCs. The BOCs owned and operated the telephone wires that connected the customers in their local markets. Other independent (non-BOC) LECs held similar monopoly franchises in their local service areas. MCI and the other IXCs were dependent on the BOCs and the independent LECs to complete the long-distance calls to the end user.

8. For much of the 1970s, MCI and AT&T fought over the fees -- the access charges -- that MCI should pay the BOCs for originating and terminating interstate calls placed by or to end users on the BOCs' local networks. That battle

took place before federal regulators, as well as in the federal courts. In December 1978, under Commission supervision, AT&T, MCI, and the other long-distance competitors entered into a comprehensive interim agreement, known as Exchange Network Facilities for Interstate Access (ENFIA), that set rates that AT&T would charge long-distance competitors for originating and terminating interstate traffic over the facilities of its local exchange affiliates.[5] Several years afterwards, AT&T's divestiture was completed, separating the local exchange operations of the BOCs from the rest of AT&T's operations, including AT&T's long-distance business. The BOCs maintained monopoly franchises in their local market, but by splitting them off from AT&T's long-distance business, the federal courts removed an incentive for the BOCs to favor AT&T's long-distance business over its competitors. Now AT&T competed directly with MCI and the other competitors to provide interstate service, and all of the competitors, including AT&T, paid the BOCs for the service of providing the necessary access to end users.

9. In 1978, the Commission commenced a wide-ranging review of the system by which LECs were compensated for originating and terminating interstate traffic. In 1983, following the decision to break-up AT&T, the Commission adopted uniform access charge rules in lieu of earlier agreements.[6] These rules governed the provision

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5 For additional background on the ENFIA agreement, *see, e.g.*, Investigation of Access and Divestiture-Related Tariffs, CC Docket No. 83-1145, Phase I and Phase II, Part 1, FCC 85-100, 57 Rad.Reg.2d 1229, 1241 (rel. March 8, 1985).

6 MTS and WATS Market Structure, CC Docket No. 78-72, Third Report and Order, Phase 1, 93 FCC 2d 241, (1983) (*1983 Access Charge Order*), *recon.*, 97 FCC 2d 682 (1983), *second recon.*, 97 FCC 2d 834 (1984).

of interstate access services by all incumbent LECs, BOCs as well as independents. The access charge rules provide for the recovery of the incumbent LECs' costs assigned to the interstate jurisdiction by the separations rules.

10. The Commission uses a multi-step process to identify the cost of providing access service. First, the rules require an incumbent LEC to record all of its expenses, investments, and revenues in accordance with accounting rules set forth in our regulations.[7] Second, the rules divide these costs between those associated with regulated telecommunications services and those associated with nonregulated activities.[8] Third, the separations rules determine the fraction of the incumbent LEC's regulated expenses and investment that should be allocated to the interstate jurisdiction.[9] After the total amount of interstate cost is identified, the access charge rules translate these interstate costs into charges for the specific interstate access services and rate elements. Part 69 of our rules specifies in detail the rate structure for recovering those costs.[10] That is, the rules tell the incumbent LECs the precise manner in which they may assess charges on interexchange carriers and end users.

11. Determining the costs that an incumbent LEC incurs to provide interstate access services and that, consequently,

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7 These rules are referred to as the Uniform System of Accounts and are contained in Part 32 of the Commission's Rules. *See* 47 C.F.R. §§ 32.1-.9000.

8 This is governed by sections 64.901-.904 of our Rules. *See* 47 C.F.R. §§ 64.901-.904.

9 This step is governed by Part 36 of the Rules. *See* 47 C.F.R. §§ 36.1-.741.

10 47 C.F.R. §§ 69.1-69.731.

should be recovered from those services, is relatively straightforward in some cases and problematic in others. Some facilities, such as private lines, can be used exclusively for interstate services and, in such cases, the entire cost of those facilities is assigned to the interstate jurisdiction by the separations rules. Most facilities, however, are used for both intrastate and interstate services. The costs of some of these facilities vary depending on the amount of telecommunications traffic that they handle. The separations rules typically assign these traffic sensitive costs on the basis of the relative interstate and intrastate usage of the facilities, as measured, for example, by the relative minutes of interstate and intrastate traffic carried by such facilities. By contrast, the costs of other facilities used for both interstate and intrastate traffic do not vary with the amount of traffic carried over the facilities, *i.e.*, the costs are non-traffic sensitive. These costs pose particularly difficult problems for the separations process: the costs of such facilities cannot be allocated on the basis of cost-causation principles because all of the facilities would be required even if they were used only to provide local service or only to provide interstate access services. A significant illustration of this problem is allocating the cost of the local loop, which is needed both to provide local telephone service as well as to originate and terminate long-distance calls. The current separations rules allocate 25 percent of the cost of the local loop to the interstate jurisdiction for recovery through interstate charges.[11]

12. In promulgating its access charge rules, the Commission has recognized that, to the extent possible,

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11 The general process of separating these costs between the interstate and intrastate jurisdictions is discussed by the Supreme Court in *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930).

costs of interstate access should be recovered in the same way that they are incurred. This approach is consistent with principles of cost-causation and promotes economic efficiency. Thus, non-traffic sensitive costs should be recovered through fixed, flat-rated fees. Similarly, traffic sensitive costs should be recovered through corresponding per-minute access rates. The Commission's rules, however, are not fully consistent with this goal. In particular, because the Commission has taken a cautious approach in addressing affordability concerns, it has taken measured steps toward this goal by limiting the amount of the allocated interstate cost of a local loop that is assessed directly on residential and business customers as a flat monthly charge.[12]

13. Through the end of 1990, access revenues were governed by "rate-of-return" regulation. Under rate-of-return regulation, incumbent LECs calculate the specific access charge rates using projected costs and projected demand for access services.[13] An incumbent LEC is limited to recovering its costs plus a prescribed return on investment, and is potentially obligated to provide refunds if its interstate rate of return exceeds the authorized level. Regulatory structures that base a firm's allowable rates directly on the reported costs of the individual firm can create perverse incentives, because reimbursing the firm's costs removes the incentive to reduce costs and improve productive efficiency.

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12 *See, e.g.*, Access Charge Reform, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982, 16010-11 (1997) (*Access Charge Reform Order*), *aff'd sub. nom., Southwestern Bell v. FCC*, 153 F.3d 523 (8th Cir. 1998).

13 Since 1981, the Commission has allowed certain smaller incumbent LECs to base their access rates on historic, rather than projected, cost and demand. *See* 47 C.F.R. § 61.39.

14. Consequently, in 1991 we implemented a system of price cap regulation that altered the manner in which the largest incumbent LECs establish their interstate access charges. While most rural and small LECs remained subject to rate-of-return rules, generally the largest incumbent LECs[14] are now subject to price cap regulations. The Commission's price cap plan for LECs was intended to avoid the perverse incentives of rate-of-return regulation in part by divorcing the annual rate adjustments from the performance of each individual LEC, and in part by adjusting the cap based on actual experience, only with a considerable lag.

15. Briefly stated, rate-of-return regulation is designed to limit the profits an incumbent LEC may earn from interstate access service, whereas price cap regulation focuses primarily on the prices that an incumbent LEC may charge and the revenues it may generate from interstate access services. Under the Part 69 cost-of-service rules, revenue requirements are based on embedded or accounting costs allocated to individual services. Incumbent LECs are limited to earning a prescribed return on investment and are potentially obligated to provide refunds if their interstate rate of return exceeds the authorized level.

16. By contrast, although the access charges of price cap LECs originally were set at the levels that existed at the time

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14 The Commission required price cap regulation for the BOCs and GTE, and permitted other LECs to elect price cap regulation voluntarily, provided that all their affiliates also convert to price cap regulation and that they withdraw from the pools administered by the National Exchange Carrier Association (NECA). Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6818-20 (1990) (*LEC Price Cap Order*).

they entered price caps, their prices have been limited ever since by price indices that have been adjusted annually pursuant to formulae set forth in our Part 61 rules. Price cap carriers whose interstate access charges are set by these pricing rules are permitted to earn returns significantly higher, or potentially lower, than the prescribed rate of return that incumbent LECs are allowed to earn under rate-of-return rules. Price cap regulation encourages incumbent LECs to improve their efficiency by harnessing profit-making incentives to reduce costs, invest efficiently in new plant and facilities, and develop and deploy innovative service offerings, while setting price ceilings at reasonable levels.[15] Individual companies retain an incentive to cut costs and to produce efficiently, because in the short run their behavior has no effect on the prices they are permitted to charge, and they are able to keep any additional profits resulting from reduced costs. In this way, price caps act as a

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15 The price cap regulations also give incumbent LECs greater flexibility in determining the amount of revenues that may be recovered from a given access service. The price cap rules group services together into different baskets, service categories, and service subcategories. The rules then identify the total permitted revenues for each basket or category of services. Within these baskets or categories, incumbent LECs are given some discretion to determine the portion of revenue that may be recovered from specific services. Subject to certain restrictions, this flexibility allows incumbent LECs to alter the access charge rate level associated with a given service. For example, within the category of switching services, an incumbent LEC may choose to recover a greater portion of its switching revenues through access charges assessed to one kind of switching service rather than through charges assessed to another switching service. Although the LEC must still observe the switched-access rate structure that is set forth in Part 69 of our rules (which determines what services may be offered and whether charges may be imposed on a per-minute or flat-rated basis), the rate level of the access charge will vary depending on the amount of revenues that the LEC chooses to recover from a given service.

transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary.[16]

17. Although price cap regulation eliminates the direct link between changes in allocated accounting costs and change in prices, it does not sever the connection between accounting costs and prices entirely. The overall interstate revenue levels still generally reflect the accounting and cost allocation rules used to develop access rates to which the price cap formulae were originally applied. Price cap indices are adjusted upwards if a price cap carrier earns returns below a specified level in a given year. Moreover, a price cap LEC may petition the Commission to set its rates above the levels permitted by the price cap indices based on a showing that the authorized rate levels will produce earnings that are so low as to be confiscatory. In the past, all or some price cap LECs were required to "share," or return to ratepayers, earnings above specified levels. This sharing requirement was eliminated in 1997.[17]

18. With the passage of the 1996 Act, the Commission determined that it was necessary to make substantial revisions to access charges. In the *Access Charge Reform Order*, the Commission instituted reforms that changed the manner in which price cap LECs recover access costs by

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16 Price Cap Performance Review for Local Exchange Carriers, Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, 11 FCC Rcd 858, 862 (1995) (*Price Cap Second FNPRM*).

17 Price Cap Performance Review for Local Exchange Carriers, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, 12 FCC Rcd 16642, 16700 (1997) (*1997 Price Cap Review Order*), *aff'd in part, rev'd in part, USTA v. FCC*, 188 F.3d 521 (D.C. Cir. 1999).

aligning the rate structure more closely with the manner in which costs are incurred.[18] Prior to such reform, some costs that did not vary with usage, in particular the local loop, were not wholly recovered through flat charges. The SLC, which is a flat charge that recovers the interstate portion of local loop costs from an end user, is subject to a cap that, particularly for residential customers, is often below the level that would enable the LEC to recover the entire interstate cost of the local loop. Prior to the *Access Charge Reform Order*, a price cap LEC recovered the shortfall created by the SLC caps wholly through the carrier common line (CCL) charge, which is a per-minute charge assessed on the end user's IXC whenever the end user placed an interstate long-distance call. The IXC, in turn, passed this charge on to its customers in the form of higher rates. By making the end-user rate for long-distance calls more expensive, the CCL charge artificially suppresses demand for interstate long-distance services.

19. The *Access Charge Reform Order* also created the PICC, a flat per-line charge imposed by a price cap LEC on an end user's IXC, in order to phase out CCL charges. The Commission sought to establish economically efficient rate structures to encourage the development of efficient competition, thereby enhancing consumer welfare. PICCs have markedly reduced the per-minute recovery of local loop costs and raised flat recovery of non-traffic sensitive costs. Unfortunately, the advent of PICCs has also created market inefficiencies. Because IXCs have recovered the residential PICCs on a per-account basis, residential customers with only one line pay the same as those with two or more lines, and so pay more than the costs IXCs have incurred for providing them service. In addition, because

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18 *Access Charge Reform Order*, 12 FCC Rcd at 16007-33.

PICCs are not assessed directly on consumers, but instead are subjected to averaging and mark-ups by the IXCs, consumers are prevented from making head-to-head comparisons among local service providers.

20. In the *Access Charge Reform Order*, the Commission also stated that its primary method for bringing about cost-based access charges was by letting competition establish efficient rates.[19] The Commission anticipated creating, in a later stage of access reform, a mechanism whereby rate regulation of services would be lessened, and eventually eliminated, as competition developed.[20] To the extent that competition did not fully achieve the goal of moving access rates toward costs, the Commission reserved the right to adjust rates in the future to bring them into line with forward-looking costs.[21] To assist in that effort, the Commission said it would require price cap LECs to start forward-looking cost studies by no later than February 8, 2001 for all services then remaining under price caps.[22]

B. Universal Service

21. One of the primary purposes of universal service support is to allow LECs and other eligible telecommunications carriers to provide certain basic services to customers in high-cost areas without having to charge these customers unaffordable rates.[23] Historically, in

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19 *Access Charge Reform Order*, 12 FCC Rcd at 16001-02.

20 Access Charge Reform Order, 12 FCC Rcd at 16003.

21 *Access Charge Reform Order*, 12 FCC Rcd at 16002-03.

22 *Access Charge Reform Order*, 12 FCC Rcd at 16003.

23 The "designated" or "core" services a carrier must provide in order to be eligible to receive universal service support include: single-party voice service; voice grade access to the public switched network; DTMF signaling or its functional equivalent; access to emergency

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the interest of meeting the goal of universal service, LEC services have been subsidized or "supported" to enable high-cost consumers to be served at rates that are reasonably comparable to those in lower cost areas. This universal service support has been both explicit and implicit.

22. *Explicit Support.* Several federal programs have provided explicit universal service support in the form of direct monetary payments to carriers. This support has been provided for both intrastate and interstate services. For example, the Commission's high-cost support mechanism provides support for the costs of the intrastate portion of the local loop that significantly exceed the national average. By providing this federal support for intrastate costs, the Commission assists the states in ensuring that rates for intrastate rates remain affordable and reasonably comparable. Several state universal service programs also provide carriers with explicit support for their intrastate rates so that those carriers can serve customers in high-cost areas without having to charge prohibitively high rates. Carriers have also received explicit federal support for their interstate costs. For example, the Commission's Long Term Support (LTS) mechanism provides certain small carriers with support for the interstate portion of the local loop. This support allows such carriers to reduce the amount of the

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services; access to operator services; access to interexchange service; access to directory assistance; and toll limitation services for qualifying low-income consumers. *See* Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8809 (1997) (*Universal Service First Report and Order*), as corrected by Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Errata, FCC 97-157 (rel. June 4, 1997), *aff'd in part, rev'd in part, and remanded in part, Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999) (affirming in relevant part the Commission's decisions regarding implementation of the high-cost universal service support mechanism).

interstate costs that they would otherwise recover through access charges.

23. *Implicit Support.* In addition to receiving explicit universal service support, LECs also received implicit universal service support from a variety of sources. Some state rate structures have permitted LECs to charge rates for certain services that significantly exceeded the costs of providing those services, thereby enabling those LECs to charge below-cost rates for other services. For example, by charging above-cost rates for vertical services (*e.g.*, caller identification, call waiting), carriers can support the rates for basic local service. The Commission's interstate access charge structure also provided LECs with implicit universal service support. For example, LECs charge business customers interstate access rates that generally exceed those charged to residential customers, even though the costs of providing access to these groups of customers does not differ significantly. In particular, the multi-line business PICC creates a subsidy running from multi-line business subscribers to residential and single-line business subscribers to help LECs recover revenues that they would not otherwise recover from residential and single-line business subscribers due to the lower SLC caps on those lines.[24] In addition, by allowing LECs to recover non-traffic sensitive (flat) costs through traffic sensitive (per minute) rates, high-volume users bear a greater share of the non-traffic sensitive costs than low-volume users, thus creating an implicit support flow from high-volume users to low-volume users. Furthermore, the practice of averaging rates over large geographic areas, for both intrastate and interstate services, results in subscribers in low-cost areas subsidizing the rates of subscribers in higher cost areas.

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24 *See Access Charge Reform Order*, 12 FCC Rcd at 16022-26.

24. *Universal Service in a Competitive Environment.* This "patchwork quilt" of implicit support helped keep rates largely affordable in a monopoly environment where incumbent LECs could be guaranteed an opportunity to earn returns from certain services and customers that are sufficient to support the high cost of providing other services to other customers. The new competitive environment envisioned by the 1996 Act, however, threatens to undermine this implicit support structure over the long run. The 1996 Act removed barriers to entry in the local market, generating competitive pressures that may make it difficult for incumbent LECs to maintain access charges above economic cost. Thus, where existing rules require an incumbent LEC to set access charges above cost for a high-volume user, a competing provider of local service can lease unbundled network elements at cost, or construct new facilities, thereby undercutting the incumbent's access charges. As competition develops, incumbent LECs may be forced to lower their access charges or lose market share, in either case jeopardizing the source of revenue that, in the past, has permitted the incumbent LEC to offer service to other customers, particularly those in high-cost areas, at below-cost prices.[25] Incumbent LECs have been claiming that this process has already made more than trivial inroads on their high-volume customer base.[26]

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25 *See, e.g.*, H. REP. NO. 204, 104th Cong., 1st Sess. 68 (1995) (The bill "would make such internal subsidies much less viable because deregulation would remove the near-guaranteed returns allowed in a regulated market, and with them the ability of the regulated firm to subsidize high-cost customers.")

26 *See, e.g.*, U S West Forbearance Petition (Phoenix), CC Docket No. 98-157 (filed Aug. 24, 1998); SBC Communications, Inc. Forbearance Petition, CC Docket No, 98-227 (filed Dec. 7, 1998); U S West Forbearance Petition (Seattle), CC Docket No. 99-1 (filed Dec. 30,

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25. Recognizing the disruptive effects that competition would have on universal service support mechanisms developed in a monopoly environment, Congress instructed the Commission, after consultation with the Federal-State Joint Board on Universal Service (Joint Board), to establish specific, predictable, and sufficient mechanisms to preserve and advance universal service.[27] Congress concluded that the support provided by these mechanisms "should be explicit and sufficient to achieve the purposes" of section 254, which include the purpose that all Americans should have access to telecommunications services at affordable and reasonably comparable rates.[28] In response to this directive, the Commission has taken several actions to put in place universal service support mechanisms that will be sustainable in an increasingly competitive marketplace. These actions fall into three general categories: (1) reforming our existing universal service support mechanisms;[29] (2) reforming our interstate access charge

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1998); and Ameritech Forbearance Petition, CC Docket No. 99-65 (filed Feb. 5, 1999).

27 47 U.S.C. § 254(a), (d). *See also* Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order Establishing Joint Board, 11 FCC Rcd 18092 (1996) (*Universal Service NPRM*).

28 47 U.S.C. § 254(b), (e). According to the Joint Explanatory Statement, the purpose of the 1996 Act is "to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition . . . ." Joint Explanatory Statement of the Committee of Conference, H.R. Conf. Rep. No. 458, 104th Cong., 2d Sess. at 113 (Joint Explanatory Statement).

29 Federal-State Joint Board on Universal Service, Seventh Report and Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, and Fourth Report and Order in CC Docket No. 96-

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regime to identify implicit universal service support and to remove such implicit support from our interstate access charges,[30] and (3) establishing new universal service mechanisms.[31] In this Order, we focus our efforts in these last two categories.

C. The Current Situation

26. Undoing the Gordian knot of determining the appropriate level of interstate access charges and converting implicit subsidies in interstate access charges into explicit, portable, and sufficient universal service support cannot be accomplished with one stroke of the sword. Determining the cost of providing service in every area of the country is a difficult, time-consuming task that regulators cannot perform with exactitude. The particular method that should be used for determining the cost of providing service is itself a contentious issue as are the results achieved from various proposed methods. The incumbent LECs have traditionally argued that they must maintain their current revenue streams to support universal service, while IXCs and consumer groups have argued that access charges should be reduced by amounts in excess of the amount that is converted into explicit universal service support. The subsidies implicit in geographic averaging must be reduced if competition is to

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262 and Further Notice of Proposed Rulemaking, 14 FCC Rcd 8078 (1999), petition for review filed *sub. nom. Vermont Department of Public Service v. FCC*, No. 99-60530 (5th Cir., filed June 23, 1999) (*Universal Service Seventh Report and Order*); Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432 (1999) (*Universal Service Ninth Report and Order*).

30 *Universal Service First Report and Order*, 12 FCC Rcd at 9162; *Access Charge Reform Order*, 12 FCC Rcd at 16144-50 .

31 *See, e.g., Universal Service First Report and Order*, 12 FCC Rcd at 9007.

develop outside of urban areas; but these subsidies can never be entirely eliminated, without pricing service on a line-by-line-by-line basis. Affordability concerns deter us from allowing end-user charges in higher cost areas to increase to the point where they recover the cost of providing service in those areas, whether cost is determined on a forward-looking or historic basis. These disputes and concerns have dragged on for years and could do so indefinitely.

27. As we devise a transition to a more economically rational approach to access charges and universal service, we need to balance various and sometimes conflicting interests – including promotion of competition, deregulation, maintaining affordability for all, and avoiding rate shock to consumers. It is important, however, that the Commission not permit itself to be gridlocked into inactivity by endeavoring to find precise solutions to each component of this complex set of problems. It is preferable and more reasonable to take several steps in the right direction, even if incomplete, than to remain frozen with indecision because a perfect, ultimate solution remains outside our grasp.

28. Against this background, certain segments of the industry have developed a comprehensive consensus approach to resolve outstanding issues concerning access charges and universal service. The Order we adopt today will result in lower rates for both low-volume and high-volume long-distance consumers, more competition, fewer line items on consumers' phone bills, greater flexibility for price cap LECs to meet competition, and an explicit, portable interstate access universal support mechanism. It is this comprehensive solution of historically contentious issues that allows us to take these actions while ensuring that consumers in high-cost areas will continue to have affordable service.

III. EXECUTIVE SUMMARY

29. CALLS has presented us with an integrated and cohesive proposal that aims to resolve major outstanding issues concerning access charges: the pending NPRM to address implicit universal service support in access charges,[32] the X-factor remand,[33] the *Low-Volume Long-Distance Users NOI*,[34] the pending NPRM on geographically deaveraging SLCs[35] and the next scheduled price cap performance review.[36] In addressing these issues, the CALLS Proposal reduces, and in most instances eliminates, implicit subsidies among end-user classes; makes implicit universal service funding in access charges explicit and portable; provides significant benefits to consumers who make few or no long-distance calls; and sets carrier charges at reasonable levels. Because we find that the CALLS Proposal resolves these issues in a way that benefits consumers and is pro-competitive and economically efficient, we adopt certain parts of the plan, largely rate structure components, as mandatory for all price cap LECs for the full five-years of the plan. As discussed in more detail below, for certain rate-level components of the plan, we adopt it as mandatory on an interim basis. Price cap LECs will be able to choose between having these interim

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32 *Universal Service Seventh Report and Order*, 14 FCC Rcd at 8078.

33 Price Cap Performance Review For Local Exchange Carriers, CC Docket No. 94-1, Further Notice of Proposed Rulemaking, 14 FCC Rcd 19717 (1999) (*1999 Price Cap FNPRM*).

34 *Low-Volume Long-Distance Users NOI*, 15 FCC Rcd 6298.

35 Access Charge Reform, CC Docket No. 96-262, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, 14320-23 (1999) (*Pricing Flexibility Order*).

36 *1997 Price Cap Review Order*, 12 FCC Rcd at 16707.

rate-level components apply for the full five years or having their rates reinitialized based on forward-looking economic cost.

30. The proposal provides for the following:

(1) Elimination of the residential PICC;

(2) Increases to the primary residential and single-line business SLC caps, beginning at $4.35 on July 1, 2000, and gradually increasing to $6.50 on July 1, 2003, provided that LECs can justify any increase beyond $5.00;

(3) A review of the SLC rates prior to the increase scheduled for July 1, 2002, including evaluation of forward looking cost information;

(4) Targeting of an X-factor[37] for switched access to switching and switched transport elements;

(5) Creation of a separate X-factor for special access services;

(6) $2.1 billion in reductions to switched access usage rates effective July 1, 2000;

(7) Reduction of the switched access X-factor to the Gross Domestic Product-Price Index (GDP-PI) once specific target rate levels are achieved;

(8) Removal of $650 million in implicit universal service support from access charges, and the creation of an explicit, portable interstate access universal service support mechanism at the same level;

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37 The X-factor is a mechanism used to reduce access rates. *See* Section IV.B. *infra* for a full discussion.

(9) Recovery of LEC universal service contributions directly from end users;

(10) Elimination of MUCs by participating long-distance carriers;

(11) A commitment by participating long-distance carriers to flow through reductions in access rates to residential and business customers over the life of the plan; and

(12) Adjustment of the Lifeline Assistance universal service support mechanism to shield low-income customers from increases in the residential SLC.

31. As an initial point, the CALLS Proposal reduces, and in many cases eliminates, implicit subsidies among customer classes through two means. First, by permitting a greater proportion of the local loop costs of primary residential and single-line business customers to be recovered through the SLC, rather than through the CCL charge and the multi-line business PICC, the CALLS Proposal reduces, and in most instances removes, the subsidies associated with both of the latter charges. Second, by permitting participating LECs to deaverage their SLCs once the CCL charge and multi-line business PICCs are eliminated, the CALLS Proposal reduces the subsidy that subscribers in low-cost areas provide those in higher cost areas.

32. The CALLS Proposal reduces these subsidies, and keeps rates affordable in high-cost areas, by replacing the subsidies with explicit interstate access universal service support. In section 254(e), Congress stated that federal universal service support should be made explicit.[38] The

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38 47 U.S.C. § 254(e).

CALLS Proposal identifies and removes $650 million of implicit universal service support in interstate access charges, creates an explicit interstate access universal service support mechanism in this amount to replace the implicit support, and makes interstate access universal service support fully portable among eligible telecommunications carriers.[39] The CALLS Proposal conforms with our tentative conclusion in the *Universal Service Seventh Report and Order* that price cap LECs should reduce their interstate access rates to reflect any increase in explicit high-cost support.[40] In addition, we conclude that this interstate access universal service support mechanism is specific, predictable and sufficient. Moreover, by making universal service support explicit and portable, the interstate access universal service support mechanism should also encourage competitive entry into high-cost areas.

33. We note that even as the CALLS Proposal phases out these subsidies, it maintains several safeguards that ensure that the rates consumers pay for the SLC remain well within a zone of reasonableness. The CALLS Proposal maintains an overall cap on the SLC assessed on primary residential and single-line business lines at $6.50, and could set the cap even lower if price cap LECs cannot justify higher increases. Thus, as explained below, CALLS ensures that basic telephone service does not become too expensive. The CALLS Proposal also asks the Commission to examine the appropriateness of setting the SLC caps for primary

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39 The interstate access universal service support is distinct from the intrastate high-cost support already in place for local rates. *See, e.g.*, *Universal Service Ninth Report and Order*, 14 FCC Rcd at 20436.

40 *Universal Service Seventh Report and Order*, 14 FCC Rcd at 8139.

residential and single-line business lines above $5.00 before doing so.[41] In addition, the CALLS Proposal provides for additional Lifeline support so that low-income subscribers will not be hurt by increases to the primary residential SLC cap. The CALLS Proposal also provides that Lifeline customers will not be assessed universal service charges by price cap LECs.[42]

34. Low-volume long-distance users also benefit from the CALLS Proposal. First, AT&T and Sprint both commit to having no monthly minimum charge on their Basic Schedule for at least three years. Second, both carriers agree to eliminate their PICC pass-through charges for residential and single-line business subscribers in light of the elimination of the PICCs for those customers. Third, in a move that benefits all subscribers, both carriers have agreed to flow through to residential and business customers the savings they realize from the CALLS-related reductions in access charges. We find that these commitments are in the public interest and adopt them as requirements of this Order.

35. Today, we adopt the CALLS Proposal because it accomplishes many objectives that the Commission to date has been unable to achieve in the absence of an industry consensus plan, while providing significant consumer benefits that we would not otherwise be able to ensure on such a wide-scale basis and in such a timely manner. We therefore find the CALLS Proposal to be in the public interest. Certainly there is no guarantee that, at the end of

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41 As revised, the CALLS Proposal acknowledges that at the time of the cost proceeding, parties can argue that certain revenues, rather than be incorporated into the SLC, should be disallowed. *See Wallman March 30 Letter* at 2.

42 *Wallman March 30 Letter* at 3; Appendix B § 69.158.

the CALLS Proposal's five-year term, competition will exist to such a degree that deregulation of access charges for price cap LECs is the next logical step. Nevertheless, the CALLS Proposal provides stability during its term and addresses several issues that have served as major obstacles to access charge reform and universal service. We also find the CALLS Proposal to be consistent with our market-based approach to regulation.

IV. DISCUSSION

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41. The rates proposed by CALLS are reasonable. We have compared LEC revenues over the five-year period under the modified CALLS Proposal with what their revenues would be under the status quo, and conclude that they are roughly the same.[51] Overall LEC revenues are roughly $700 million lower than they would have been for the first year of the plan, but gradually increase in the later years so that projected revenue is higher than the status quo at the end of the plan. We note, however, that these estimates make no adjustment to account for voluntary reductions participating LECs might make in response to the development of competition in the marketplace, something that is much more likely to occur in the later years of the

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[51] *See* Appendix C, Graphs 1 and 2. These calculations assume that the X-factor remains at 6.5 percent, but that inflation remains relatively low, at 1.95%. If inflation is higher, the CALLS Proposal produces lower overall rates relative to the status quo. Our estimates are based on applying our current rules and the CALLS Proposal's proposed rules to publicly available data, so we are puzzled by MCI's insistence that CALLS should have released its own estimates. *See* MCI Supp. Comments at 3-5; *see also* New Jersey Div. Supp. Comments at 4-5; Ad Hoc Supp. Reply at 5-6.

plan, in part due to the reduction of implicit subsidies by the CALLS Proposal.[43]

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64. In the *1983 Access Charge Order*, the Commission established a comprehensive mechanism for LECs to recover their costs of providing access service to complete interstate and foreign telecommunications.[81] This mechanism distinguished between traffic sensitive costs and non-traffic sensitive (NTS) costs incurred by a LEC to provide interstate access service. The Commission emphasized in the *1983 Access Charge Order* that its long range goal was for LECs to recover a large share of their NTS common line costs on a flat-rated basis from end users instead of from carriers.[82] The rules adopted in 1983 apportioned charges for common line costs between a monthly flat-rated SLC assessed on end users and a per-minute CCL charge assessed on the IXCs, which ultimately was recovered from end users through long-distance charges.[83]

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43 *See also* CALLS Supp. Reply at 39-41.

81 *1983 Access Charge Order*, 93 F.C.C.2d at 241. Although we had not moved to a price cap regulatory regime at that time, LECs who later became price cap LECs were subject to the access charge system.

82 *1983 Access Charge Order*, 93 F.C.C.2d at 264-65. The Commission found that a subscriber who does not use the subscriber line to place or receive interstate calls imposes the same NTS costs as a subscriber who does use the line. Thus, simply by requesting telephone service, the subscriber causes local loop costs whether she uses the service for intrastate or interstate calls. *1983 Access Charge Order*, 93 F.C.C.2d at 278.

83 Thus, LEC common line revenues = end-user SLC "plus" (CCL charge "times" usage), when access charges were first adopted.

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2. CALLS Proposal

70. The CALLS signatories propose reforming and simplifying common line charges by combining the SLC, PICC and CCL charges into a single end-user charge that can be deaveraged under limited circumstances. Under the CALLS Proposal, the PICC for residential and single-line businesses would be eliminated beginning July 1, 2000.[96] The SLC for primary residential and single-line business lines would be capped at $4.35 upon implementation of the proposal beginning July 1, 2000, $5.00 as of July 1, 2001, $6.00 as of July 1, 2002, and $6.50 as of July 1, 2003.[97] The proposal also calls for the Commission to initiate a proceeding after the SLC cap reaches $5.00 to examine whether increases to the SLC cap for residential and single-line businesses above $5.00 are appropriate, and reflect the costs in the UNE zone or zones where they would apply.[98] The maximum primary residential and single-line business SLC in any zone would be the average price cap common line, marketing and transport interconnection charge revenue (Price Cap CMT Revenue) per line for the highest cost unbundled network element (UNE) zone[99] in a study area up

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[96] Modified Proposal at § 2.1.2.1.

[97] Modified Proposal at § 2.1.2.2.1. *See* Appendix C, Chart 1 for a comparison of the SLC and PICC caps under our current rules and as proposed by CALLS.

[98] Although the CALLS Proposal describes this cost review proceeding to be limited to primary residential and single-line business lines, CALLS subsequently clarified its submission to include all residential lines as part of the proposed cost review proceeding. *See Wallman March 30 Letter* at 2.

[99] A UNE Zone is a state created zone pursuant to section 51.507(f) of the Commission rules, which requires states to establish different rates for unbundled network elements in at least three defined geographic areas within the state to reflect geographic cost differences.

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to the nominal cap.[100] Price Cap CMT Revenue is defined as the total revenue a filing entity is permitted to receive for SLCs, PICCs and CCL charges.[101] Price Cap CMT Revenue also includes marketing expenses pursuant to section 69.156(a) of the Commission's current rules, and residual interconnection charge revenues collected through PICCs.[102]

71. In addition to eliminating the PICC for non-primary residential lines, the CALLS Proposal would cap the maximum SLC for these lines at the lower of $7.00 or the greater of the current rate or average Price Cap CMT Revenue per line for the highest average revenue per line UNE zone in a study area.[103] Once charges for primary and non-primary residential lines are equal within a zone or study area, a price cap LEC could eliminate the distinction between primary and non-primary lines within that zone or study area.[104] Although the distinction between primary and non-primary residential lines could be eliminated in most circumstances under the proposal, it would remain for those subscribers where the average Price Cap CMT Revenue exceeds the maximum primary residential SLC cap.

72. For multi-line business customers, the SLC and PICC would not be combined.[105] The multi-line business

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47 C.F.R. § 51.507(f).

[100] Modified Proposal at §§ 2.1.1.1, 2.1.2.2.1.

[101] Under the CALLS Proposal, the price cap LEC common line revenues for residential and single-line businesses = end-user SLC "plus" (CCL charge "times" usage).

[102] Modified Proposal at § 2.1.1.1.

[103] Modified Proposal at §§ 2.1.3.1, 2.1.3.2.1.

[104] Modified Proposal at § 2.1.3.2.3.

[105] Under the CALLS Proposal, the price cap LEC common line revenues for multi-line businesses = end-user SLC "plus" IXC PICC "plus" (CCL charge "times" usage).

PICC would continue to be charged to the IXCs with a cap of $4.31 per line.[106] It would be reduced as the residential SLCs increase until it is phased out.[107] The SLC would be the lesser of $9.20 or the greater of (1) the rate as of June 30, 2000, less certain amounts of SLC reductions or (2) Average Price Cap CMT Revenue Per Line where SLCs have not been deaveraged.[108] Multi-line business SLCs would be frozen until the carrier's multi-line business PICC and CCL charges are eliminated – except where a carrier chooses to reduce the SLC through voluntary reductions.[109]

73. SLCs could be deaveraged subject to certain limitations.[110] Price cap LECs could only geographically deaverage their SLCs after a state commission establishes deaveraged UNE rates by zone and PICCs and CCL charges are eliminated. Deaveraged SLCs by customer class within each UNE zone also could not generate more revenue than that generated by geographically averaged SLCs.[111] A price cap LEC, however, could take a voluntary reduction at any time. Price cap LECs may have up to four SLC zones, absent Commission review and approval, and price cap LECs can determine which zones to consolidate if they have more than four UNE zones.[112] A carrier need not eliminate CCL charges and PICCs prior to deaveraging by voluntary reductions. A price cap LEC also could not reduce multi-line business SLCs below non-primary residential SLCs or

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106 Modified Proposal at § 2.1.4.1.

107 Modified Proposal at §§ 2.1.4.1, 2.1.6.

108 Modified Proposal at § 2.1.4.2.1.

109 Modified Proposal at § 2.1.4.2.1. "Voluntary Reduction" is one in which the price cap LEC reduces prices other than through offset. Modified Proposal at § 2.1.5.6.3.

110 Modified Proposal at § 2.1.5.

111 Modified Proposal at §§ 2.1.5.1, 2.1.5.5, 2.1.5.6.1.

112 Modified Proposal at §§ 2.1.5.2, 2.1.5.6.1.

non-primary residential SLCs below primary residential and single-line business SLCs in a given UNE pricing zone.[113] SLCs of a given customer class, such as multi-line business, could not have a lower price in higher cost zones than any line in a lower cost zone.[114] Finally, except with respect to voluntary reductions, the proposal would establish a minimum charge within the lowest cost zone, which allows consumers outside the lowest cost zone to share the benefits of SLC deaveraging.[115]

74. Each CALLS LEC signatory also commits to reduce "switched access usage charges" by its proportional share of $2.1 billion on July 1, 2000.[116] Most LECs would achieve these reductions solely through rate decreases. Under the proposal, however, two mutually exclusive alternatives are proposed to permit certain carriers to move some of these permitted revenues to the common line basket.[117]

3. Discussion

75. We adopt the common line rate structure aspects of the CALLS Proposal because it is pro-competitive and provides immediate significant consumer benefits through reduced consumer rates. Furthermore, consistent with the 1996 Act, including § 254(k), it simplifies the current rate structure and long-distance bills, reduces consumer confusion, and furthers the Commission's efforts over the past two decades to eliminate per-minute recovery of common line costs.[118] Although support for the CALLS

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[113] Modified Proposal at § 2.1.5.3.

[114] Modified Proposal at § 2.1.5.4.

[115] Modified Proposal at § 2.1.5.6.2.

[116] Modified Proposal at § 3.2.4.

[117] Modified Proposal at §§ 3.2.4.1, 3.2.4.2; *see* Section IV. B. *infra* for discussion of this portion of the CALLS Proposal.

[118] 47 U.S.C. § 254(k).

Proposal was not unanimous, the proposal is a major step forward from the Commission's current access charge regime, and preferable in moving access charges to cost-based levels than the current process.[119]

Residential and Single-Line Business SLCs and PICCs

76. In this Order, we eliminate residential and single-line business PICCs. We also increase the related SLC caps as proposed and modify our rules accordingly. As explained below, we find that this action is within the Commission's statutory authority to order proper recovery of the portion of common line costs that has been allocated to the interstate jurisdiction through charges imposed on telephone subscribers, and that doing so does not violate the Communications Act of 1934, as amended.[120]

77. Our actions today are in furtherance of our goal of having price cap LECs recover a large share of their NTS common line costs from end users who cause them instead of carriers, and to recover these costs on a flat-rated, rather than a usage-sensitive, basis.[121] As explained below, we

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[119] Cable & Wireless Comments at 1-3; CompTel Comments at 2, 10; Western Wireless Reply at 2; Cincinnati Bell Comments at 2; Cincinnati Bell Supp. Comments at 6; Global Crossing Supp. Comments at 1; Qwest Supp. Comments at 2-3.

[120] 47 U.S.C. §§ 4(i), 201-205; *see National Association of Regulatory Utility Commissioners v. Federal Communications Commission*, 737 F.2d 1095, 1114 (D.C. Cir. 1984) (*NARUC v. FCC*) (Commission may properly order recovery, through charges imposed on telephone subscribers, of the portion of loop costs placed in the interstate jurisdiction); *see also Smith v. Illinois Bell*, 282 U.S. at 148-49 (portion of the costs of local subscriber plant relating to interstate services may be recovered only under the authority of a body with interstate regulatory powers).

[121] *See 1983 Access Charge Order*, 93 F.C.C.2d at 264-65, 278;

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find that modifying these charges in the proposed manner will simplify the current rate structure and consequently consumers' bills by eliminating some of the complexity involved with these charges and the billing practices that gave rise to the *Truth-in-Billing Order* and *Low-Volume Long-Distance Users NOI*.[122]

78. By eliminating the residential and single-line business PICCs, the CALLS Proposal establishes a straightforward, economically rational pricing structure which enables consumers to make a choice among competing providers through head-to-head comparisons and better promotes competition by sending potential entrants economically correct entry incentives.[123] Furthermore, because of the PICC billing practices of many IXCs, the new SLC caps ultimately will result in a further reduction of the overall amount many consumers currently pay for their individual SLCs and PICCs. Most IXCs currently recover PICCs from their customers through a blended PICC pass-through charge[124] on a per-account basis. This practice results in consumers with only one line paying more than they otherwise would had the LECs simply passed onto them directly the $1.04 worth of permitted revenues that the LEC recovers through the single-line PICC.[125] We estimate

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see also Access Charge Reform Order, 12 FCC Rcd at 16007.

[122] Truth-in-Billing and Billing Format, CC Docket No. 98-170, First Report and Order, 14 FCC Rcd 7492 (1999) (*Truth-in-Billing Order*); *Low-Volume Long-Distance Users NOI*; *see also* CALLS Comments at 9.

[123] *See* CALLS Comments at 9-10.

[124] The "blended PICC pass-through charge" is the flat, averaged, monthly IXC charge to end users designed to recover the PICC that the long-distance carriers were paying regulated local carriers for primary and secondary lines.

[125] Indeed, under our existing rules, we have permitted LECs to

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that IXCs are recovering additional amounts per account in "transaction costs" to recover their Lifeline costs, universal service contributions and bad debt associated with non-paying subscribers. Specifically, while we estimate that the average IXC blended PICC pass-through rate absent any additional amounts recovered by IXCs currently is approximately $1.23,[126] AT&T, MCI WorldCom ar 1 Sprint currently charge their residential customers $1.51, $1.46 and $1.50, respectively, as a blended PICC pass-through charge on a per-account basis. Eliminating the PICC, therefore, will make common line billing more efficient and more closely aligned with costs.[127]

79. Under the CALLS Proposal, the primary residential and single-line business SLC cap will be less than the combined SLC and PICC would be beginning July 1, 2000 under our existing rules. Under our existing rules, the primary residential and single-line business SLC currently is capped at $3.50 per line. The primary residential and single-line business PICC cap currently is $1.04 per line, and it is scheduled to increase on July 1, 2000 by $0.50 per line, plus an amount for inflation.[128] The total amount of the SLC and

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bill the PICC directly to end users who do not presubscribe to an IXC. The PICC charged in these situations has generally been less than those charged by IXCs. *See Access Charge Reform Order*, 12 FCC Rcd at 15999; *see also* American Petroleum Comments at 4.

[126] This estimate is based upon a weighted average of the primary residential PICC and the non-primary residential PICC as of January 1, 2000. This figure is estimated to increase under our current rules to $1.46 on July 1, 2000.

[127] This assumes that long-distance carriers eliminate PICC pass-through charges for residential customers, consistent with the commitment letters from AT&T and Sprint. *See AT&T March 30 Letter* at 2; *Sprint February 25 Letter* at 1.

[128] The inflation rate adjustment would result in an additional increase of approximately 2.8 per cent based upon the inflation rate

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PICC caps beginning July 1, 2000 under existing rules therefore, would be approximately $5.06. Under the CALLS Proposal, the primary residential and single-line business SLC is capped at $4.35 per line beginning July 1, 2000. Consequently, most subscribers with only one line could save more than $0.70 per line under the CALLS Proposal compared to amounts they otherwise might have paid had these caps gone into effect beginning July 1, 2000. This estimate does not reflect the additional savings that result from the elimination of the blended PICC pass-through. Given that the new SLC cap will be less than the SLC and PICC caps would be under our current rules, we have a sufficient basis to find that the rates charged primary residential and single-line business customers will not be excessive and therefore unreasonable. Furthermore, because per-line CMT revenues are below the proposed caps in some areas, the average primary residential and single-line business SLC will not be as high as the cap particularly if the caps are raised in 2002 and 2003. We estimate the average primary residential SLC will be $4.93 in July 2001, $5.63 in July 2002, $5.82 in July 2003, and $5.83 after full implementation and transition of the proposal in July 2004 if the caps are fully implemented not counting voluntary reductions due to competition or any modifications to the proposed caps which might occur as a result of the cost review proceeding prior to the SLC increasing above $5.00.[129] It is difficult to compare these rates with the

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during the time period specified under the Commission rules. *See* 47 C.F.R. § 69.152(k)(2).

[129] Our estimate is based upon publicly available data filed by the price cap LECs with their tariffs and the CALLS Proposal's projections of the sum of the primary line SLC (charged to end users) and the primary line PICC charge (charged to carriers) over the five-year term of the proposal. In addition, GTE estimates that the primary residential SLC at the end of the plan will be approximately $5.80 which is only

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estimated primary residential SLC and PICC rates in 2004 under our current rules because of variables beyond our control. For example, the SLC under the CALLS Proposal's proposed rules is largely unaffected by inflation, whereas the projected SLCs and PICCs under our current rules would vary widely depending on what happens with inflation over the time period. In addition, further into the future, it is more difficult to estimate what IXCs would charge as a PICC pass-through to end users, and what the X-factor would be.

80. Similarly, the SLC cap for non-primary residential lines will be lower than the SLC cap that would otherwise apply beginning July 1, 2000. The non-primary residential SLC cap currently is $6.07 per line and is scheduled under our current rules to increase on July 1, 2000 by $1.00 per line, plus an amount for inflation. Additional increases to this SLC cap of $1.00 per line plus an amount for inflation also are scheduled in subsequent years.[130] Under the CALLS Proposal, the non-primary residential SLC cap will be $7.00 beginning July 1, 2000, and remain unchanged for the five-year term of the proposal.[131] Because the actual charges assessed on many non-primary residential lines will be below the SLC cap under either approach, these subscribers will not see additional benefits. However, the remaining subscribers will immediately benefit by saving

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$0.30 more than the combined flat-rate amount that consumers could expect to pay for the SLC under existing rules beginning July 1, 2000, plus the IXC blended PICC pass-through charge IXCs could be expected to charge at that time. GTE Supp. Reply at 24.

[130] 47 U.S.C. § 69.152(e)(2)(ii).

[131] Modified Proposal at § 2.1.3.2.1.

approximately $0.24, and on average will enjoy considerable savings in subsequent years.[132]

81. We find that this rate restructuring and rate decrease is in the public interest because it simplifies the current rate structure, moves towards cost-based rates, reduces consumers' overall rates, and simplifies long-distance bills, thereby resulting in less consumer confusion. Similarly, simplifying the current rate structure benefits price cap LECs and IXCs by eliminating some of the complexities involved in the administration of current Commission rules and providing greater opportunities for pricing flexibility. These are all goals we have sought to achieve through our access charge reform, truth-in-billing and low-volume long-distance user proceedings.[133]

82. We recognize that although consumers will experience considerable immediate savings, they also will see an additional line item charge on their bill when price cap LECs begin recovering Universal Service Fund contributions through an end-user charge. This charge could have been assessed regardless of the CALLS Proposal as a result of the Fifth Circuit's decision in *Texas Office of Public Utility Counsel v. FCC*.[134] Although the removal of

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[132] We estimate that the non-primary residential SLC cap on July 1, 2000 under current Commission rules will be approximately $7.24 based upon a Gross Domestic Product Price Index (GDP-PI) of 2.8% for the 18 month period ending March 31, 2000. Because the PICC pass-through charge is currently assessed by IXCs on a per-account basis, most consumers do not pay an additional PICC for non-primary lines. For this reason, we do not take the elimination of the non-primary PICC into consideration when considering the difference between the status quo and the CALLS Proposal.

[133] *See 1999 Price Cap FNPRM*; *Low-Volume Long-Distance Users NOI*; *Truth-in-Billing Order*.

[134] *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393

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the implicit subsidies from access charges to an explicit universal service support mechanism will be part of this line item charge, the increase attributed to the interstate access universal service support mechanism should be offset by the decreases in other rates and charges resulting from the implementation of the CALLS Proposal.

83. As set forth in the CALLS Proposal, we shall review any increases to residential and single-line business SLC caps above $5.00 to verify that any such increases are appropriate and reflect higher costs where they are to be applied.[135] We will initiate and complete a cost review proceeding prior to any scheduled increases above this cap taking effect to determine the appropriate SLC cap. For this proceeding, the price cap LECs have agreed to provide, and we will examine, forward-looking cost information associated with the provision of retail voice grade access to the public switched telephone network. We will address in that proceeding whether an increase in the SLC cap above

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(5th Cir. 1999) (affirming in part the Commission's decisions regarding implementation of the high-cost universal service support system, and reversed in part the Commission's decision that incumbent LECs could recover their universal service contributions from access charges). *See* Section IV. C. *infra* for a discussion of the interstate access universal service support mechanism portion of the CALLS Proposal.

135 We note that in other proceedings, we are considering allowing price cap LECs to adjust their depreciation rates to amortize the difference between their regulatory books and financial books through a five-year above-the-line amortization. *See* 1998 Biennial Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers, CC Docket 98-137, Further Notice of Proposed Rulemaking, FCC 00-119 (rel. Apr. 3, 2000) (*Depreciation Relief NPRM*). We emphasize here that any decision to permit above-the-line amortization in that docket will have no affect on the Commission's cost proceeding.

$5.00 is warranted and, if not, whether a decrease in common line charges is warranted.[136]

84. We disagree with CALLS opponents who argue that this cost study should occur prior to the adoption of the proposal.[137] This proposal is good for all end users because it reduces the overall rates paid by them. Initiating and completing a cost study would take a considerable amount of time, which would delay the immediate savings end users would realize from the implementation of the proposal on July 1, 2000. Scheduling the cost study prior to the SLC cap increasing above $5.00 in July 2002, will enable end users to reap the immediate benefits of this proposal without the delay that would otherwise result from conducting the study beforehand. We further disagree with CALLS opponents who want the Commission today to specifically define the scope of the cost review study as well as the specific information to be examined in it. We believe that these issues are more appropriately addressed when we initiate the cost study.

85. We are not persuaded by arguments that increasing the SLC cap would violate the principle set forth in section 254(b) that consumers in all regions of the nation should have affordable access to telecommunications and information services at rates that are reasonably comparable to those services provided in urban areas.[138] The SLC cap

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[136] *See Wallman March 30 Letter* at 1.

[137] Wyoming Commission Supp. Comments at 3-4; NASUCA Supp. Comments at 5, 20; New Jersey Div. Supp. Comments at 5; Joint Consumer Commenters Supp. Comments at 15-18.

[138] The universal service policies of 47 U.S.C. § 254(b), among others, provide that

> Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should

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was set over a decade ago and was determined to be generally affordable.[139] It has never been adjusted for inflation. Our rate restructuring today will result in lower overall charges than consumers experience with the current SLC and PICC, and a more efficient recovery of common line revenues through flat charges.[140] Furthermore, the data indicate that if the SLC cap for primary residential lines had been adjusted annually for inflation since it became effective in 1984, by July 2000, the $3.50 primary residential and single-line business SLC cap that was in place in 1989 and retained in the *Access Charge Reform Order* would have increased to $4.94 per line.[141] Thus, for residential customers, the primary residential SLC cap we adopt today is more affordable now than what it otherwise would have been had the $3.50 cap we previously deemed affordable been adjusted for inflation annually.

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have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

47 U.S.C. § 254(b)(3).

139 *See Access Charge Reform Order*, 12 FCC Rcd at 16008-09.

140 Carrier common line charges would have decreased more rapidly than they have to date had the SLC caps been adjusted over time for inflation. This would have resulted in a more efficient recovery of non-traffic sensitive per-line common line costs through flat charges than what has occurred to date.

141 *See Access Charge Reform Order*, 12 FCC Rcd at 16015-16. As in our *Access Charge Reform Order*, adjustments for inflation are based upon the Consumer Price Index (CPI) rather than GDP-PI, for comparison purposes because consumer affordability issues relate more to the CPI than to the GDP-PI.

86. Increasing the SLC cap and eliminating the PICC as proposed will, in most areas, enable the full recovery of common line revenues for residential and single-line business lines through a single charge. Although, in the past, the Commission was reluctant to increase the SLC cap, the CALLS Proposal mitigates our reluctance.[142] Indeed, although we established the PICC as a charge that LECs assess IXCs instead of an end-user charge in order to minimize any impact on end users potentially resulting from a higher SLC, the reality in the marketplace is that IXCs have marked-up and passed-through the PICC to end users, thereby imposing higher flat charges for the majority of residential customers than would have occurred had we increased the SLC cap by the amount of the PICC caps. Even an end user who does not presubscribe to an IXC, and who pays the PICC directly to the LEC, could have been paying more in SLC and PICC on July 1, 2000, than the proposed SLC in the CALLS Proposal. Furthermore, subscribership has not been negatively impacted by these charges. Since the introduction of these charges, subscribership rates have remained relatively stable.[143] We are unpersuaded by the arguments therefore, that revising the rate structure as proposed will negatively impact subscribership.[144] Thus, in light of all of the benefits associated with the proposed restructuring of common line billing, such as the savings shown above, reductions in switched access usage rates and the interstate access universal service support mechanism of the CALLS Proposal, our prior concerns about whether increasing the

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142 *See Access Charge Reform Order*, 12 FCC Rcd at 16010-11.

143 *See* Telephone Subscribership in the United States, FCC Common Carrier Bureau, Industry Analysis Division (released January 2000).

144 Joint Board Supp. Comments at 12.

SLC cap above $3.50 would render telephone service unaffordable are sufficiently mitigated to allow an increase in the SLC.

87. We acknowledge that states are concerned about the impact the CALLS Proposal may have on intrastate access charges, due to the fact that many states require that intrastate access fees mirror interstate access charges.[145] We agree with the Joint Board in the *Second Recommended Decision*, that "[t]he Commission's efforts to remove implicit universal service support from interstate access charges will not affect intrastate rates directly."[146] We believe that the states' concern over an indirect consequence of our action today is outweighed by our efforts, consistent with the 1996 Act, to remove implicit supports from access charges. For this reason, and because the 1996 Act directs that states should take action to preserve and advance universal service,[147] we leave it to the individual states to adjust their rates as they deem necessary in response to this Order.

88. In addition, the CALLS Proposal will provide rate benefits for rural customers including those not served by price cap LECs.[148] Most IXCs currently assess a flat-rated charge to recover the PICC on all of their subscribers, including those subscribers served by rate-of-return LECs. By eliminating the PICC, we eliminate these charges from

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[145] Joint Board Supp. Comments at 11.

[146] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Second Recommended Decision, 13 FCC Rcd 24744, 24755 (1998) (*Second Recommended Decision*).

[147] 47 U.S.C. § 254(f); Policy and Rules Concerning the Interstate, Interexchange Marketplace, CC Docket 96-61, Report and Order, 11 FCC Rcd 9564 (1996).

[148] NADO Reply at 5.

the bills of these subscribers as well. This benefit is in addition to the savings they otherwise will experience from the reductions in long-distance charges resulting from the pass through by the long-distance signatories of the proposed lower access charges.[149] Because long-distance providers must offer their geographically-averaged rates to all of their customers, including those served by rate-of-return carriers,[150] rural customers also will benefit from reductions in per-minute rates. We also anticipate addressing access reform and universal service reform for rural carriers in the near future.[151]

89. Some of the proposal's critics suggest that the more appropriate competitive route to access reform is to eliminate the SLC rather than the PICC.[152] These parties believe that, because the long-distance market is currently more competitive than the local exchange market, these charges are more likely to be competed away if assessed on IXCs. We disagree with this proposition. Because PICCs are an external cost to the IXCs that they cannot reduce by managing it better or being more efficient, PICCs are unlikely to be competed away.[153] Indeed, we are now into the third year of its introduction, and there is no sign that the

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149 *See AT&T March 30 Letter* at 2; *Sprint February 25 Letter* at 2.

150 47 U.S.C. § 254(g).

151 The Rural Task Force is scheduled to make recommendations to the Joint Board in early Fall 2000. *See also* Letter from David B. Cohen, Vice President – Small Company Affairs, United States Telecom Association, to Magalie Roman Salas, Secretary, FCC, March 17, 2000, CC Docket 98-77 (submitting Multi-Association Group Plan for Rate-of-Return Regulated Services).

152 New Jersey Div. Comments at 11; NASUCA Comments at 33; New Jersey Div. Supp. Comments at 7-8; NASUCA Supp. Comments at 8-9, 17-18.

153 GTE Supp. Reply Attachment B at 2.

PICC is being competed away. Rather, we believe that one of the major benefits of recovering common line costs through the SLC alone is to encourage efficient competitive entry, particularly in providing competing alternatives for loop service.[154] The only way an IXC can reduce its PICCs is by discouraging presubscription by customers that it would prefer not to serve, such as those who make few long-distance calls. This type of behavior could raise issues regarding unjust, unreasonable and discriminatory practices under sections 201[155] and 202[156] of the 1996 Act. This is not a result that we would like to encourage. If common line costs are recovered in the SLC, a LEC can reduce its costs through efficiency gains and will have the incentive to avoid costs and reduce prices as it faces increased competition from competing local exchange carriers.[44] Further, we find that the proposed cost recovery structure

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154 *See* CALLS Reply at 29.

155 47 USC § 201(b) states

> All charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, any such charge, practice, classification, or regulation that is unjust or unreasonable is hereby declared to be unlawful.

47 U.S.C. § 201(b).

156 47 USC § 202(a) states

> It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of person, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage.

47 U.S.C. § 202(a).

44 *See* CALLS Supp. Reply at 17-18.

will be more apparent to the end user, whereas PICCs currently are at least partially buffered against direct comparison because of the manner in which they are processed from the LEC through the IXC to the end user. Proceeding in this manner will provide greater economic incentives to stimulate alternative sources for the loop through facilities-based competition, and thus subject loop prices to competitive pressure.

90. Opponents also argue that the CALLS Proposal violates section 254(k) of the 1996 Act[158] for two reasons: (1) it fails to recover costs from all services that use the loop and permits the uncompensated use of the loop by IXCs; and (2) it causes services included in the definition of universal service to bear more than a reasonable share of the joint and common costs of facilities used to provide those services.[159]

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[158] 47 U.S.C. § 254(k) states

> A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocations rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

47 U.S.C. § 254(k).

[159] *E.g.*, Smithville Comments at 5; NASUCA Comments at 20-22; Washington Commission Comments at 9-10; California Commission Comments at 11; Joint Consumer Commenters Reply at 3-5; New Jersey Div. Comments at 7-8; Michigan Commission Supp. Comments at 3; Montana Commission Supp. Comments at 3; Wisconsin Commission Supp. Comments at 5-7; Joint Board Supp. Comments at 9-10; Joint Consumer Commenters Supp. Comments at 4, 26, 37-38; NASUCA Supp. Comments at 6, 21-22.

91. We find that section 254(k) is not implicated by our action today. Section 254(k) is directed at the allocation of costs between competitive and non-competitive services, both regulated and non-regulated, and prohibits subsidization of competitive services by non-competitive services.[160] The SLC is a method of recovering loop costs; not an allocation of those costs between supported and unsupported services.[161] Contrary to the opponents' arguments, nothing in section 254(k) precludes the Commission from permitting recovery of common line charges properly apportioned to interstate access from subscribers on a flat-rated basis. Under current rules, no PICC or CCL charges are paid by IXCs with respect to non-primary residential and multi-line business lines after the phase-in specified in the *Access Charge Reform Order* is completed. Similarly, for primary residential lines that are not presubscribed to an IXC, there is no common line recovery from IXCs in those places where the CCL charge has been phased out.

92. Moreover, section 254(k) addresses the concern that price cap LECs may attempt to gain an unfair market advantage in competitive markets by allocating to their less competitive services, for which subscribers have no available alternative, an excessive portion of the costs incurred by their competitive operations.[162] Whether a LEC allocates all of its interstate loop costs to the end user or to the IXC, the LEC's competitive position as compared to

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[160] 47 U.S.C. § 254(k); *see* Implementation of Section 254(k) of the Communications Act of 1934, as Amended, 12 FCC Rcd 6415, 6419 (1997) (*Section 254(k) Order*).

[161] *See Southwestern Bell Telephone v. Federal Communications Commission*, 153 F.3d 523, 559 (8th Cir. 1998).

[162] *Section 254(k) Order*, 12 FCC Rcd at 6419-20.

other suppliers of local exchange facilities remains the same. Section 254(k) was not designed to regulate the apportionment of loop costs between end users and IXCs because this allocation does not involve improperly shifting costs from a competitive to non-competitive service.[163]

93. Consequently, we agree with the CALLS proponents that there is no legal impediment to a federal recovery mechanism that simply requires all telephone subscribers to pay, on a per-line basis, for that portion of their *necessarily-incurred local telephone plant costs* that is assigned to the interstate jurisdiction.[164] Section 254(k) does not apply to the question of whether prices should be set through SLCs alone or through a combination of SLCs and PICCs. Neither the PICC nor the CCL charge is legally compelled by section 254(k) or any other provision of law.

94. Indeed, these arguments have already been addressed and rejected by the United States Court of Appeals for the Eighth Circuit.[165] In *Southwestern Bell v. FCC*, the Texas Office of Public Utility Counsel argued, among other things, that the Commission's decision in the *Access Charge Reform Order* to increase the SLC cap for certain lines resulted in a "'free ride by the IXCs on the common line facilities'" and that loop costs were being shifted from competitive services to basic services, contrary to the intent of section 254(k) of the 1996 Act. Texas Counsel argued that as a result of section 254(k), the recovery of joint and common costs, such as NTS loop costs, must be borne mutually both by end users and by IXCs. Texas Counsel

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[163] *See Southwestern Bell v. FCC*, 153 F.3d at 559.

[164] *See* CALLS Reply at 27; *see also NARUC v. FCC*, 737 F.2d at 1115.

[165] *See Southwestern Bell v. FCC*, 153 F.3d at 559.

asserted that it was improper for the Commission to shift additional NTS loop cost recovery from the access rates LECs charge IXCs for interstate access onto the rates end users pay for certain telephone lines.[166] Texas Counsel contended that increasing the SLC cap imposed on end users allowed IXCs to evade their fair share of the common line costs.[167] Texas Counsel maintained that this approach violated section 254(k) "in that the existing proportion of NTS loop cost recovery by the IXCs through competitive services would be reduced through increases on end users for basic services."[168]

95. The Eighth Circuit upheld the Commission's increases to various LEC SLC caps, however, and found that "Texas Counsel's contention that increasing the SLC price ceiling violates the prohibition against using non-competitive services to subsidize competitive services [wa]s unpersuasive."[169] In doing so, the court reaffirmed the Commission's long standing view that the subscriber "causes" local loop costs, whether the subscriber uses the service for intrastate or interstate calls. These costs are, in any event, recovered from the end user, either through direct end-user charges or indirectly through higher rates or additional charges paid to IXCs. The court further affirmed the Commission's conclusion that it was appropriate and rational for the Commission to impose these costs on the end user. The court concluded as a result that increasing

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166 *See Southwestern Bell v. FCC*, 153 F.3d at 559.

167 *See Southwestern Bell v. FCC*, 153 F.3d at 559.

168 *See Southwestern Bell v. FCC*, 153 F.3d at 558-59.

169 *See Southwestern Bell v. FCC*, 153 F.3d at 559.

SLC caps on certain lines did not result in a windfall for IXCs.[170]

96. Similarly, the court in *Southwestern Bell* rejected the argument that increasing the SLC cap violates the second sentence of section 254(k) by causing services included in the definition of universal service to bear more than a reasonable share of the joint and common costs of facilities used to provide those services. The second provision of section 254(k) separates telecommunications services into those that are supported by universal service, and those that are not.[171] This provision empowers the Commission to establish rules to prevent LECs from overallocating to supported services the costs of facilities that are used to provide services in both categories. It places a continuing obligation on the Commission to ensure that the treatment of joint and common costs, such as corporate overheads, prescribed by our accounting, cost allocation, separations, and access charge rules will safeguard the availability of universal service.[172] Opponents argue that by eliminating the PICC and increasing the SLC cap, the Commission violates section 254(k) by allocating 100 percent of the joint and common costs to the common line elements paid by the end user. The Commission, however, has complied with the requirements of section 254(k) by allocating joint and common costs to various interstate services, including those that are supported by universal service, such as common line and switching, and those that are not, such as special access services.[173] The Commission also has in place a

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[170] *See Southwestern Bell v. FCC*, 153 F.3d at 558.

[171] 47 U.S.C. § 254(k); *see Southwestern Bell v. FCC*, 153 F.3d at 559.

[172] *Section 254(k) Order*, 12 FCC Rcd at 6420.

[173] *See, e.g.*, 47 C.F.R. §§ 69.401-414.

comprehensive system of accounting and non-accounting safeguards designed to discourage carriers from misallocating the costs of non-regulated activities, and to ensure that ratepayers share in any efficiencies generated from joint use of the network by non-regulated activities.[174] None of the proposal's critics challenge these safeguards as insufficient or flawed, or our allocation as improper. Because the SLC is a method of recovering properly allocated loop costs, not an allocation of those costs between supported and unsupported services, section 254(k) is not implicated.[175]

97. Moreover, the SLC and PICC were established to recover loop costs for the same service – interexchange access. Interexchange access is a supported service as defined in the *Universal Service First Report and Order*.[176]

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[174] *See, e.g.*, Regulatory and Policy Problems Presented by the Interdependence of Computer and Communications Services and Facilities, Tentative Decision, 28 FCC 2d 291 (1970); Final Decision and Order, 28 FCC 2d 267 (1971), *aff'd sub. nom GTE Services Corp. v. FCC*, 474 F.2d 724 (2d Cir. 1973); *decision on remand*, 40 FCC 2d 293 (1973); Amendment of Section 64.702 of the Commission's Rules and Regulations, 77 FCC 2d 384 (1980), *recon.* 84 FCC 2d 50 (1980), *further recon.* 88 FCC 2d 512 (1981), *aff'd sub nom. Computer and Communications Industry Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983); Policy and Rules Concerning Rates for Competitive Carrier Services and Facilities Authorizations Thereof, CC Docket No. 79-252, Fifth Report and Order, 98 FCC 2d 1191 (1984); Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies, CC Docket No. 86-111, Report and Order, 2 FCC Rcd 1298 (1987) (*Joint Cost Order*), *recon.* 2 FCC Rcd 6283 (1987), *further recon.* 3 FCC Rcd 6701 (1988), *aff'd sub nom. Southwestern Bell Corp. v. FCC*, 896 F.2d 1378 (D.C. Cir. 1990).

[175] *See Southwestern Bell v. FCC*, 153 F.3d at 559.

[176] *Universal Service First Report and Order*, 12 FCC Rcd at

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Therefore, contrary to the arguments of opponents, moving the recovery of loop costs associated with interexchange access service from the PICC to the SLC is not a change in the allocation between supported and unsupported service.

98. We also reject the argument that elimination of the PICC is inconsistent with the *Line Sharing Order*.[177] The *Line Sharing Order* concluded that states should not permit incumbent LECs to charge more to competitive LECs for access to shared local loops than the amount of loop costs the incumbent LEC allocated to ADSL services when it established its interstate retail rates for those services.[178] To date, we are not aware of any incumbent LECs that have allocated any loop costs to ADSL services.

99. Many of the proposal's critics also erroneously argue that the consolidation of the SLC and PICC violates the requirements for reasonable recovery of shared costs as interpreted by *Smith v. Illinois Bell*.[179] We find no requirement anywhere that we are required to prescribe the recovery of properly allocated common line costs from IXCs rather than in the cost causative manner that we follow. In making their arguments, the opponents misinterpret and confuse the issues in *Smith v. Illinois Bell*. Indeed, their arguments have already been addressed and rejected in *NARUC v. FCC*. Specifically, in *NARUC v. FCC*, the D.C.

8807.

[177] NASUCA Supp. Comments at 7; Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket 98-147, Third Report and Order, 14 FCC Rcd 20912 (1999) (*Line Sharing Order*).

[178] *Line Sharing Order*, 14 FCC Rcd at 20976.

[179] NASUCA Comments at 19-22; Joint Consumer Commenters Comments at 16-18; NRTA/NTCA Comments at 9-10; *see also Smith v. Illinois Bell*, 282 U.S. 133.

Circuit held that *Smith v. Illinois Bell* dealt with jurisdiction and that a portion of the costs of local subscriber plant may be recovered only under the authority of a body with interstate regulatory powers.[180] The D.C. Circuit further held that *Smith v. Illinois* did not address the manner in which the Commission was to perform this task.[181] The court specifically found that *Smith v. Illinois Bell* did not compel the Commission to use a particular formula to recover costs allocated to its jurisdiction.[182] Rather, the Commission may properly order recovery, through charges imposed on telephone subscribers, of the portion of the local loop costs, that, in accordance with *Smith v. Illinois,* have been placed in the interstate jurisdiction.[183] Contrary to the arguments of many opponents, therefore, *Smith v. Illinois Bell* does not preclude our action today as the common line costs in question have been properly allocated by the Commission.

100. In this Order, we also permit price cap LECs to eliminate over time the distinction between primary and non-primary residential lines. Under the revised proposal, this distinction can be eliminated in most circumstances, but will remain for those subscribers where the average CMT revenue exceeds the maximum proposed SLC cap for primary residential lines.[184] This will go a long way to eliminate the consumer confusion that now exists relating to this distinction. Although the primary/non-primary line

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[180] *See NARUC v. FCC*, 737 F.3d at 1112.

[181] *See NARUC v. FCC*, 737 F.3d at 1112.

[182] *See NARUC v. FCC*, 737 F.3d at 1112; *see also Rural Telephone Coalition v. Federal Communications Commission,* 838 F.2d 1307, 1314 (D.C. Cir. 1988).

[183] *See NARUC v. FCC*, 737 F.3d at 1114

[184] We estimate that by July 2004, the distinction can be eliminated for approximately two-thirds of all non-primary lines.

distinction has served a role during the transitional regulatory process we established, we agree that eliminating this distinction to the extent that we can will further simplify the current rate structure and eliminate the costs associated with administering this distinction, which are ultimately borne by consumers.

101. We also eliminate the Marketing Basket in this Order. We established this basket in our *Access Charge Reform Order* to prevent price cap LECs from recovering retail marketing expenses from carrier access services, and to ensure that the recovery of these expenses was directed at multi-line users rather than primary residential and single-line business users. Under current Commission rules, the marketing expenses allocated to the Marketing Basket are recovered through common line charges.[185] Under the CALLS Proposal, these marketing expenses are included in the total revenue a price cap LEC is permitted to recover as Price Cap CMT Revenue.[186]

102. We adopt the CALLS Proposal with respect to its treatment of marketing expenses. In doing so, we expand the common line elements from which these expenses can be recovered to include the primary residential and single-line business SLC. In the *Access Charge Reform Order* we prevented the recovery of marketing expenses from primary residential and single-line business SLCs and PICCs because we believed that price cap LEC retail marketing may have focused more on the sale of optional vertical features such as call waiting and caller ID, and on features

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[185] 47 C.F.R. § 69.156. Marketing expenses can be recovered from multi-line business and non-primary residential SLCs, then multi-line business and non-primary residential PICCs, then CCL charges.

[186] Modified Proposal at § 2.1.1.1.

and services designed for business customers.[187] At the time, there was insufficient evidence in the record demonstrating that price cap LECs marketed to primary residential and single-line business subscribers. As a result, we determined that the most efficient and cost-causative method for recovering these expenses was from the end users to whom the price cap LECs' marketing was directed – multi-line business and non-primary residential line end users.[188] We therefore limited recovery of these expenses to the non-primary residential and multi-line business common line elements in the common line basket.[189] In addition, by proceeding in this manner, we avoided potential universal service concerns relating to increasing the primary residential SLC.[190]

103. Since the adoption of the *Access Charge Reform Order*, evidence has developed which demonstrates that price cap LECs incur marketing expenses relating to primary residential and single-line business services as well.[191] Consequently, consistent with the cost-causative approach we adhered to in the *Access Charge Reform Order*, we now permit the recovery of these expenses from all elements in the common line basket, including the primary residential and single-line business SLC.

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187 *See Access Charge Reform Order*, 12 FCC Rcd at 16121.

188 *See Access Charge Reform Order*, 12 FCC Rcd at 16122.

189 *See Access Charge Reform Order*, 12 FCC Rcd at 16122.

190 *See Access Charge Reform Order*, 12 FCC Rcd at 16122.

191 *See* Letter from Anthony M. Alessi, Director, Federal Relations, Ameritech, to William F. Caton, Acting Secretary, Federal Communications Commission, September 11, 1997, CC Docket No. 96-262; Letter from Frank G. Kennedy, Director, Legal and Regulatory Affairs, United States Telephone Association, to William F. Caton, Acting Secretary, Federal Communications Commission, September 29, 1997, CC Docket No. 96-262.

104. This change will have little, if any, impact on subscribers, given the existence of the SLC caps, the elimination of the primary and non-primary residential PICCs, and the distribution of these expenses across a larger subscriber base. In light of the integrated nature of the CALLS Proposal and the considerable benefits resulting from the simplification of and overall rate reductions in the common line basket, the reductions to the switched access usage charges, and the implementation of the interstate access universal service support mechanism, our prior universal service concerns relating to increasing the primary residential and single-line business SLC cap above $3.50 are allayed. The overall effect of the proposal is to lower costs for consumers. Eliminating this basket also promotes efficiency and streamlines the process by which a price cap LEC recovers its marketing expenses, while at the same time reducing the administrative costs associated with maintaining and managing this basket.

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VI. ORDERING CLAUSES

265. IT IS ORDERED, pursuant to sections 1, 4(i) and (j), 201-209, 218-222, 254, and 403 of the Communications Act, as amended, 47 U.S.C. §§ 151, 154 (i), 154(j), 201-209, 218-222, 254, and 403 that this Order IS HEREBY ADOPTED as described above.

266. We, therefore, ORDER that the Inquiry initiated in CC Docket 99-249 is hereby TERMINATED. This action is taken pursuant to authority contained in Sections 4(i) and 303 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 4(i), 303.

267. IT IS FURTHER ORDERED that the Commission's Consumer Information Bureau, Reference

Information Center, SHALL SEND a copy of this Order, including the Final Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

268. IT IS FURTHER ORDERED that the provisions in this Order SHALL BE EFFECTIVE immediately upon publication in the Federal Register. Pursuant to 5 U.S.C. § 553(d)(3), we find good cause exists to have the rules take effect immediately upon publication in the Federal Register. Local exchange carriers subject to price cap regulation must file access reform tariffs no later than June 16, 2000 in order for them to be effective by July 1, 2000, as required by Section 69.3 of the Commission's rules, 47 C.F.R. § 69.3. In addition, to ensure that the local exchange carriers subject to price cap regulation have actual notice of these rules immediately following their release, we are serving those entities by overnight mail. The collections of information contained within are contingent upon approval by the Office of Management and Budget.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

§ 69.152 End user common line for price cap local exchange carriers.

[PUBLISHER'S NOTE: Paragraph (h) was added at 64 FR 16353, 16358, Apr. 5, 1999, effective July 1, 1999.]

(a) A charge that is expressed in dollars and cents per line per month shall be assessed upon end users that subscribe to local exchange telephone service or Centrex service to the extent they do not pay carrier common line charges. A charge that is expressed in dollars and cents per line per month shall be assessed upon providers of public telephones. Such charge shall be assessed for each line between the premises of an end user, or public telephone location, and a Class 5 office that is or may be used for local exchange service transmissions.

(b) [Reserved]

(c) The charge for each subscriber line associated with a public telephone shall be equal to the monthly charge computed in accordance with paragraph (k) of this section.

(d)(1) Beginning July 1, 2000, in a study area that does not have deaveraged End User Common Line Charges, the maximum monthly charge for each primary residential or single-line business local exchange service subscriber line shall be the lesser of (i) the Average Price Cap CMT Revenue Per Line as defined in § 61.3(d) of this chapter or (ii) the following:

(A) On July 1, 2000, $4.35.

(B) On July 1, 2001, $5.00.

(C) On July 1, 2002, $6.00.

(D) On July 1, 2003, $6.50.

(2) In the event that GDP-PI exceeds 6.5% or is less than 0%, the maximum monthly charge in paragraph (d)(1)(ii) of this section and the cap will be adjusted pursuant to § 61.45(b)(1)(iii) of this chapter.

(e)(1) Beginning July 1, 2000, in an study area that does not have deaveraged End User Common Line Charges, the monthly charge for each non-primary residential local exchange service subscriber line shall be the lesser of:

(i) $7.00, or

(ii) the greater of:

(A) The rate as of June 30, 2000 less reductions needed to ensure over recovery of CMT Revenues does not occur, or

(B) Average Price Cap CMT Revenue Per Line.

(2) In the event that GDP-PI is greater than 6.5% or is less than 0%, the maximum monthly charge in paragraph (e)(1)(i) of this section and the cap will be adjusted pursuant to § 61.45(b)(1)(iii) of this chapter.

(3) Where the local exchange carrier provides a residential line to another carrier so that the other carrier may resell that residential line to a residence that already receives a primary residential line, the local exchange carrier may collect the non-primary residential charge described in paragraph (e) of this section from the other carrier.

Section 254(b)(5)

SPECIFIC AND PREDICTABLE SUPPORT MECHANISMS.— There should be specific, predictable and and sufficient Federal and State mechanisms to preserve and advance universal service.

Section 254(f)

STATE AUTHORITY.— A state may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State. A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.

Section 254(k)

SUBSIDY OF COMPETITIVE SERVICES PROHIBITED.— A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.